

**CURRENT ISSUES BEFORE THE FINANCIAL
ACCOUNTING STANDARDS BOARD**

HEARING
BEFORE THE
SUBCOMMITTEE ON
COMMERCE, TRADE, AND CONSUMER PROTECTION
OF THE
COMMITTEE ON ENERGY AND
COMMERCE
HOUSE OF REPRESENTATIVES
ONE HUNDRED SEVENTH CONGRESS
FIRST SESSION

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(II)

CONTENTS

	Page
Testimony of:	
Jenkins, Edmund L., Chairman, Financial Accounting Standards Board ...	14
Leisenring, James J., Board Member, International Accounting Standards Board	23
Rogstad, Barry K., President, American Business Conference	24

(III)

CURRENT ISSUES BEFORE THE FINANCIAL ACCOUNTING STANDARDS BOARD

TUESDAY, JULY 31, 2001

HOUSE OF REPRESENTATIVES,
COMMITTEE ON ENERGY AND COMMERCE,
SUBCOMMITTEE ON COMMERCE, TRADE,
AND CONSUMER PROTECTION,
Washington, DC.

The subcommittee met, pursuant to notice, at 10:06 a.m., in room 2123, Rayburn House Office Building, Hon. Cliff Stearns (chairman) presiding.

Members present: Representatives Stearns, Shimkus, Btyant, Walden, Terry, Bass, Tauzin (ex officio), Towns, Harman, Rush, and Eshoo.

Staff present: Ramsen Betfarhad, majority counsel; Brian McCullough, professional staff; Shannon Vildostegui, professional staff; David Cavicke, majority counsel; Will Carty, legislative clerk; and Consuela Washington, majority counsel.

Mr. STEARNS. Good morning. The subcommittee will come to order and I welcome our witnesses this morning.

One of the more important areas of our committee's jurisdiction is over accounting standards. This is, sort of, something that is dry, but this is very important, as we are going to find out today and as we look at what has happened in the past.

The general public, of course, is not excited as they might be, but this is our jurisdiction and it is fundamental to the health of our economy that we maintain the most accurate and transparent reporting system. The need for reliable financial reporting is growing more important with each passing year. Whether people are aware of it or not, accounting standards affect most of our systems and, thus, necessitate that we maintain the highest accounting standards practicable.

Americans are increasingly preparing for their future financial needs by investing in public companies through retirement plans and individual accounts. More than half of all of Americans are now invested in the equity markets in one form or another. Since most Americans have a stake, directly or indirectly, in equity markets, reliable and accurate information on finance is very important on publicly traded companies, and the emerging global economy also dictates that we maintain high standards.

Geographical boundaries are no longer a barrier to trade and commerce in our evolving digital world. While this has opened new doors for U.S.-based companies, it also means that our companies face increased competition in a global marketplace.

While one of the benefits of this dynamic is a greater and more efficient flow of capital across borders, it requires us to constantly monitor our reporting standards to ensure our standards attract capital rather than present a barrier.

And the competitive landscape is not confined to the large publicly traded companies. Private companies seeking capital are increasingly able to solicit foreign investment.

I strongly support our structure of an independent standard setter. The transparency of our accounting standards and reporting system are primary to the decisionmaking process of investors and I think they would agree.

I find the results of FASB, or the Financial Accounting Standards Board's business combinations project and the related accounting treatment for intangible assets, as outlined in statements 141 and 142, speak well for having a private, independent standards setting broad. FASB should be commended for an open process that included several public hearings and working with all parties to understand their concerns regarding business combinations.

What FASB has accomplished is a tall order, considering that less than 2 years ago interested parties were vociferously debating business acquisition and we had one case where the acquire had reflected only 5 percent of the acquisition cost as expenses or costs.

Although the resolution of the project is extremely important, I do have a broader question: I wonder whether our model or system of accounting is keeping pace with an economy that is rapidly changing and whether changes to the existing system will accurately reflect the financial position of a company. The question raises more serious concerns when placed in the context of the international standards.

Obviously, achieving universally accepted standards that provide efficiency and comparability across borders has undeniable merit. Although I would like to think accounting standards and the structure of the IASB would be free from politicalization, we have seen some difficulties arise in many efforts to reach global agreements with our foreign counterparts.

I support the structure and process and perhaps the fact that it is private will reduce potential hurdles. Nonetheless, I have several questions regarding the impact of international standards on U.S. businesses and U.S. GAAP standards. Transparent international standards will be an invaluable change but only if it is available to all businesses.

Finally, my colleagues, I would be remiss if I did not raise the issue of pro forma versus GAAP, the General Accepted Accounting Principles, reporting of financial data by publicly traded companies with today's witnesses. I find value in both types of reporting, yet I would like to see two things transpire regarding pro forma reporting.

First, some level of standardization should be applied to pro forma reporting so that an individual investor, such as myself, could make heads or tails out of that reporting system. I think FASB can play a constructive role in this regard. I do appreciate that pro forma reporting should be flexible enough to be responsive to a particular company's or industry's dynamics. However, if every company comes up with its own definitions, the utility of pro forma

reporting is diminished for a small investor as he or she has no frame of reference to compare the pro forma results with, and this takes me to my second point.

The pro forma statements, I believe, should be released simultaneously with a company's 10-Q filing with the SEC. The simultaneous release of those results will accord a small investor the opportunity to truly understand and appreciate the pro forma results.

Furthermore, I would recommend that each company provide for a comprehensive reconciliation table between its pro forma and 10-Q reported results. I think this issue is of a substantial import to the small investor and I think FASB has a key role in adding some structure to pro forma reporting.

In conclusion, I would add that our accounting standards are the best in the world and I respect FASB for their efforts to constantly improve them in the face of this changing world global economy. I look forward to our dialog with FASB and IASB and look forward to their testimony.

And with that, the distinguished gentleman from New York, the ranking member, Mr. Towns?

Mr. TOWNS. Thank you very much, Mr. Chairman, for holding this hearing.

Let me begin by also commending Mr. Tauzin, the chairman of the full committee, for his hard work on the January 2001 memorandum of understanding that preserves our jurisdiction over FASB and the setting of accounting standards and I would like to thank him for that as well, and you, too, Mr. Chairman.

I welcome all the speakers and I am looking forward to hearing from them today. I am hopeful that we will hear an overview about the board's involvement in this ever-changing world over the next few years, for both investors and the private sector. The protection of the consumers of this country depends on the high standards the board sets for the many investors in the financial industry. After all, performance levels for the institutions governed by FASB require strong standards as well as leadership. That is the regulatory responsibility that I and the members of this subcommittee will expect from the board.

I was also pleased that, under the leadership of former SEC Chairman Arthur Levitt, many in the accounting and consulting industry came to an agreement with the Securities and Exchange Commission last year regarding the necessary protections for American investors.

Mr. Chairman, FASB affects so many investors and organizations in my home State of New York. I always want both consumers and the business community to understand the important responsibility the board has to the American public. I hope that all parties involved in setting standards will work together for a better future.

I yield back the balance of my time and I look forward to hearing from the witnesses.

Mr. STEARNS. The gentleman yields back the balance of his time. The gentleman from Illinois?

Mr. SHIMKUS. Thank you, Mr. Chairman, and I appreciate the hearing.

Sometimes I wish my sister was with me. I have five of them so I do not wish that very often, but one is an accountant and these are the days that I long for her to be at my side to help go through some of the vocabulary.

I appreciate the independence of both the organizations and I think it is critical. I also appreciate the move to increase transparency which I think is the ultimate goal of what we need to apply here, and as we change in this age, we were talking about the stubby pencils and erasers, and, obviously, we are in a different era and standards have to change to meet the new standards.

I am also concerned about this linkage. We do have oversight. We appreciate you coming. I want to make sure that we are not legislating or impacting on what the independent organizations do. We do have a role to play in consumer protection, but I think good will and work done by both parties can assure that we can perform our role as you perform yours.

It will be interesting to listen to the discussions on these two statements; the two methods of limiting pooling and purchasing, along with the good will and intangible assets. I hope to learn a little bit more about that. And I am going to take this great big testimony of a gazillion pages, Mr. Jenkins, and give it as a gift to my sister for some light reading in the evening.

So with that, Mr. Chairman, I yield back my time.

Mr. STEARNS. I thank the gentleman.

The gentleman from New Hampshire? Mr. Bass, no statement?

Mr. Walden? No statement? All right.

The chairman of the full committee is recognized.

Chairman TAUZIN. How is that for timing?

Mr. STEARNS. That is perfect.

Chairman TAUZIN. Let me first thank you for holding this important oversight hearing today.

Although accounting remains largely in the background of public policymaking, it occasionally warrants the focused attention of Congress and, in particular, the committee that would raise those questions about its impact on commerce. Indeed, the committee has searched its jurisdiction over FASB precisely because this organization's role in accounting standards setting is extremely important to commerce, in general, but most importantly to the evolving new economy that is characterized by the high-tech sector, in particular, where accounting rules and accounting customs are challenged in a dramatic new way.

The direct relationship between accounting and the changing economy is best illustrated by the issues encountered during FASB's recent work to revise the standards on accounting for business combinations. And while FASB's initial proposal last year had the laudable goal of improving financial transparency, it did not sufficiently address practical problems created by applying the old world brick and mortar's accounting standards to businesses in the digital economy, where literally eyeballs might be worth more than actual brick and mortar investments.

Intellectual property and technological innovations do not necessarily depreciate the same way assembly line machines and warehouses depreciate. Thus when FASB initially proposed eliminating the so-called pooling accounting method for business com-

binations, often used by the rapidly growing new economy companies with substantial intangible assets, in favor of the so-called purchase method, failed to provide an adequate guidance for identifying and valuing those intangible assets.

During the hearings on these standards in the last Congress, I asked FASB to resist eliminating pooling unless purchase-method accounting was improved to address the realities of today's economy. This included addressing the method of accounting for intangibles. I am pleased to see that FASB has made a good deal of progress since the last time Mr. Jenkins testified before the committee, and the recently issued standards attempted to address the concerns, in fact, raised by this committee last year.

I would like to commend FASB for modernizing appraisals of intangible assets to reflect the realities of many information-based companies. I first want to tell you that that is no easy task and I am cautiously optimistic, however, that the approach you have taken may, in fact, work for us. You clearly worked hard to acquire and act upon the best information before issuing the final standard and I appreciate that, but I have some remaining concerns about the application of the new standards.

Are the triggering incidents accurate and precise or are they gray areas? Are the impairment tests too burdensome? What are the costs associated with the new system? In particular, how will small and middle-sized companies handle the cost and the administrative requirements associated with a new approach? I hope, Mr. Jenkins, you will answer some of those questions today in your testimony.

In addition to the new standards for business combinations, we are going to hear a bit about the development of the IASB, the International Accounting Standards Board. With a charter to achieve a single set of global accounting standards, the IASB's mission is neither small nor easy. International consistency in accounting standards is becoming increasingly important in the global economy; Mr. Chairman, as important as the question of international standards on privacy that I know you have focused on so mightily in the last few hearings.

However, the desire of the international harmonization must be balanced with our domestic need for accurate and transparent account as is provided by the U.S. GAAP and the need to retain our international competitiveness. I suggest the U.S. will not easily stray from GAAP unless an alternative is acceptable and necessary. Congress and this committee, in particular, will play a strong oversight role in the adopting of international standards by the U.S., and I hope to gain some reassurance that FASB will be active in pushing for strong, harmonized standards that will not undermine our system nor put our companies at a disadvantage with their international competitors.

Again, I want to thank the chairman for this important hearing.

And, again, Mr. Jenkins, I want to thank you and the board for listening, I think, very well and for taking very seriously our concerns last year and for, as I said, making, I think, extraordinary progress on answering those concerns.

Thank you, Mr. Chairman.

Mr. STEARNS. Thank you.

And I say to the chairman earlier, both Mr. Towns and I, had praised your leadership in that FASB jurisdiction was retained in our committee and we recognize that.

The gentlelady from California, Ms. Eshoo?

Ms. ESHOO. Thank you, Mr. Chairman.

And good morning to our distinguished panel that are here with us this morning.

While there really is not a current issue, at least in my view, that is created a need for the hearing, I still think that it is very important that we track with one another to hear from certainly the distinguished chairman of the FASB board, and it is good to see you here this morning, as well as our other guests.

I also want to commend the Financial Accounting Standards Board for its recently completed work with regard to business combinations and I always look forward to working with you on issues that will come before you.

When I first came to the Congress I made the assumption that every Member of Congress, on the other side of the Capitol and here, knew what FASB was, and I quickly found out that I was just about the only one that did. And so, I set out on a course where I had to educate members first, as I was trying to educate myself about how the Congress worked.

It was an issue. And I introduced legislation recognizing that FASB was an independent body, and I still think that that is a very, very important element for every single Member of Congress to respect. But also understanding that the decisions that are made by this accounting standards board do have an effect on our national economy, and Congress certainly weighs in on that.

At that time the issue was relative to stock options. And I worked for 2 years, and as we were just reorganizing for the next Congress the news came about the decision that the FASB board had taken. And I was delighted about the decision that was made then. So very early on I came to work on issues that FASB works on as well.

I think that FASB and its members understand, perhaps, better today than when I first arrived to the Congress that, while the body is independent, that we do weigh in and that we have a keen interest in a whole number of areas.

Why? I think the chairman of the full committee has delineated some of the reasons. We want companies to have the ability to not only retain their employees, but that it is very new in a knowledge-based economy. And so, in many ways we are partners, in other ways that may be viewed that we are adversarial, but always we have a, I think, responsibility, in terms of oversight to be tracking with one another.

I think that our efforts have gone a long way in bringing about a full and public debate; most recently on the business combinations issue. So I think that just as there is the sand in the oyster, where it is aggravating, as it were, that we want to bring about some pearls. And I guess what we call that in Congress is a workable, consensus solution, whatever those words might mean.

I have expressed concern about FASB's perception regarding its process of private sector standard setting and I have also been an advocate for always protecting its independence. God help us if the

Congress gets into writing accounting standards; that is not what we need, and I do not think that is what our role is. I admire and respect the work its leadership and the staff devote to developing proposals and standards, and I applaud that commitment.

The perspective and the education hearings such as this one have given us, have allowed to conduct worthwhile oversight, especially in the area of the new economy. And while we are having a somewhat tough time, the new economy is not going to go away; it is here to stay. So I think that the charting for our course together is really a very important one.

So once again, Mr. Chairman, thank you for calling a hearing. And whatever may come up during it, I think we are going to make good use of that information.

And once again welcome to Chairman Jenkins and the others that are here today. I appreciate that and I always look forward to working with you.

Thank you.

Mr. STEARNS. I thank the gentlelady.

The gentlelady from California, Ms. Harman?

Ms. HARMAN. Thank you, Mr. Chairman.

I want to congratulate you, again, for holding another oversight hearing. It is very useful, especially for the rookies on this committee, to have the chance to learn about some of these things before we have to deal with all of the various disasters that befall us and them.

I want to point out to my friend and colleague, Ms. Eshoo, that I did know what FASB stands for before I came to Congress. I was a corporate lawyer in my last life. Some wish that I would return to that very quickly, but I am, at least, intent on trying to add what I can here.

I would just say to FASB that the recent changes were enormously welcome to the business world and to us in Congress; very helpful.

In the future, I think, FASB will be challenged again in several respects. One is internationally. I think it is very important to make certain that the rules we have domestically fit appropriately in the international marketplace.

And in that regard, I know that there is another organization, but I do not know how to pronounce its acronym, the International Accounting Standards Board. Is that IASB? No. I-A-S-B, all right. Well, shows what I know. But anyway, that is one board, I just coined a new phrase. That is another area that will constantly require attention and perhaps change.

And finally, I would make a comment about the digital economy. I am not sure it is new anymore. I think it is getting old; certainly, those of us trying to figure out what it does are getting old.

But the way I would see this is, it is constantly required of those of us in government or in independent agencies to figure out digital solutions to the issues that the digital economy faces. We were all trained in the analog world, or those of us slightly older than our children were trained in the analog world. And it is often hard for us to think about how a proposed solution can work in a digital economy.

So I see two new challenges for FASB. One is constantly to reassess its role in the international economy. And the second is to think digitally and think about how accounting solutions work with those in an economy that interacts with them on a digital basis.

Thank you, Mr. Chairman. I look forward to learning more under your tutelage. I yield back.

[The prepared statement of Hon. Jane Harman follows:]

PREPARED STATEMENT OF HON. JANE HARMAN, A REPRESENTATIVE IN CONGRESS
FROM THE STATE OF CALIFORNIA

Mr. Chairman, it is clear that the Financial Accounting Services Board, which has the responsibility to set and improve accounting and reporting standards for all private and public companies funded by the private sector, serves an important purpose.

With an increasing number of Americans becoming equity owners in American businesses, the FASB's role in providing clear and accurate information for consumers has become even more relevant to the average American than it was in the past.

Therefore, because Congress has oversight authority over FASB, we must take the necessary steps to ensure the effectiveness of the FASB for consumers and other users of financial information.

One of the primary issues for this hearing- the recently issued standard on business combinations holds special significance because it affects methods of accounting for mergers and acquisitions. With an increasing number of mergers and acquisitions, consumers and others need accurate information to make investment decisions and to track future returns on their investments.

I am looking forward to hearing the testimony from our panel of witnesses today and to learn more about why the FASB decided to require all business combinations initiated after June 30 to be accounted for with the purchase method as opposed to the pooling of interests method.

I am also interested in other efforts by the FASB to improve accounting and reporting standards to benefit consumers.

Finally, our world has become much smaller and other markets clearly have an effect on our own. The same attention which is given to our own markets should be applied on an international level, and I know that the FASB has been a proponent of developing high quality international accounting standards. Congress also has a responsibility to insure that the FASB is taking the proper steps to influence the policy and standards of the International Accounting Standards Board (IASB).

Mr. Chairman, thank you for holding this important hearing and these are issues, which we must continue to monitor to insure that consumers receive the information they need to make the best decisions possible regarding their investments. Ultimately, this will be good for the American public and the American economy.

Mr. STEARNS. Thank you, gentlelady.

And I believe those are all the opening statements for members.
[Additional statement submitted for the record follows:]

PREPARED STATEMENT OF HON. JOHN D. DINGELL, A REPRESENTATIVE IN CONGRESS
FROM THE STATE OF MICHIGAN

Due to the press of other House business, including work on the patients' rights legislation and the Rules Committee hearing on pending energy legislation, I was unable to attend yesterday's hearing. I thank the distinguished Ranking Member of the Subcommittee, Mr. Towns, for extending my regrets and I also thank the distinguished Subcommittee Chairman, Mr. Stearns, for granting my request to submit a statement for the hearing record. I appreciate the opportunity to work with both of my colleagues on this and other issues.

The work of the Financial Accounting Standards Board (FASB), though obscure by many standards, is vital to the fair and efficient operation of our capital markets and the conduct of commerce and trade.

The Securities Act of 1933 and the Securities Exchange Act of 1934 established a system of fair, honest, reliable, and transparent disclosure as the keystone of our markets. The Securities and Exchange Commission (SEC) was given responsibility for administering those statutes for the protection of investors and the public interest. The SEC has always looked to the private sector for leadership in establishing

and improving financial accounting and reporting standards for publicly held companies, and in 1973, formally gave that responsibility to FASB.

It's a tough job but one that FASB has performed admirably and in the public interest. In the process, FASB has had several near-death experiences. For example, the banks tried to have FASB abolished for suggesting that banks should mark certain financial assets to market just like everybody else. Then the bankers tried to rein in the SEC and FASB efforts to improve accounting for derivatives and hedging and the disclosure of registrants' derivatives and market risks.

More broadly, Corporate America has tried to have FASB abolished for suggesting that stock options are an expense that should be reflected on balance sheets. Yet in a speech two summers ago, Alan Greenspan, the Federal Reserve Board chairman, said stock options helped "impede judgments about prospective earnings" and, over the last five years, had caused companies to overstate profit growth by one to two percentage points each year. Moreover, an article in the Sunday, July 29, 2001, *New York Times*, "Disposing the Myth That Options Help Shareholders," reports on research showing stock options repricings to be an egregious transfer of wealth from shareholders to managements.

We expect FASB to tackle these difficult issues in an open and deliberate manner that provides extensive due process. We do not expect FASB to duck issues because they are controversial or because there is no industry consensus on the subject. Sometimes the industry consensus is to do the wrong thing. We expect FASB to listen to all of its constituents and work with them; consensus will follow. We expect FASB to exercise strong leadership in these matters.

In that regard, I appreciate the contributions made by the witnesses. I agree with the outcome on business combinations although I have some reservations about the ability to game the impairment test. This matter merits close scrutiny by FASB and by the regulators.

Former Secretary of the Treasury Lawrence H. Summers once observed: "The single most important innovation shaping the [American capital] market was the idea of generally accepted accounting principles. We need something similar internationally." I agree. Therefore, I look forward to hearing more in the future about the work of the International Accounting Standards Board (IASB) toward establishing high quality standards to govern global transactions. Such efforts have fizzled in the past. I hope that the IASB can succeed where others have failed.

In June, the *Wall Street Journal* reported that the SEC was investigating whether a handful of companies may have announced deceptive financial results to the public by touting misleading "pro forma" earnings in their quarterly news releases. It appears as if some companies are intentionally trying to deceive investors by issuing news releases highlighting pro forma earnings, which conveniently omit items that would reduce earnings. The real results are then filed weeks later with the SEC in the company's quarterly or annual earnings report. Sounds like fraud to me. I urge the SEC to take appropriate action promptly to curb this abuse. I associate myself with the concerns expressed by Chairman Stearns at the hearing and would be pleased to work with him to solve this problem.

I also want to work with Chairman Stearns and Ranking Member Towns, as well as the Financial Services Committee, on accounting fraud. I am inserting in the hearing record with my statement a recent press report, "SEC List of Accounting-Fraud Probes Grows," *Wall Street Journal*, Friday, July 6, 2001, indicating that the SEC has a record nearly 260 accounting investigations under way. This suggests that companies and accountants are subverting GAAP and the rules laid down by FASB and the SEC. At my request, the General Accounting Office has agreed to examine the governance system of the accounting profession and the issues raised by the outbreak of record levels of accounting fraud. (I am enclosing copies of those two letters for the record.)

Lastly, I commend full Committee Chairman Tauzin for his negotiations on the memorandum of understanding that preserved this Committee's jurisdiction over accounting standards. This Committee, particularly its Subcommittee on Oversight and Investigations which I chaired, has a long and distinguished history on accounting matters. Under our stewardship, the quality of information we receive from U.S. companies exceeds that of almost any other nation. We can be proud of that.

[Friday, July 6, 2001—The Wall Street Journal]

SEC LIST OF ACCOUNTING-FRAUD PROBES GROWS

By Michael Schroeder, Staff Reporter of THE WALL STREET JOURNAL

WASHINGTON—The Securities and Exchange Commission's list of companies under investigation for possible accounting fraud is growing longer, just as the agency's limited resources are being stretched more than ever before.

SEC officials say they have nearly 260 accounting investigations under way, a big jump from recent years. They aren't just small firms—the chief focus of the SEC's enforcement actions historically. Some 15% of the probes, or about 40, are focusing on companies that are among, the nation's 500 biggest.

"If we had nothing else to do, the accounting investigations alone could keep us busy for the next five or 10 years," Richard Walker, the SEC's enforcement chief, said in an interview. "The size and magnitude are crushing."

The drumbeat of headline-grabbing accounting scandals, at firms led by **Cendant Corp.**, **Sunbeam Corp.** and **Rite Aid Corp.**, is also getting attention on Capitol Hill. Lawmakers are beginning to call for more SEC resources to combat fraud. The SEC's division of corporation finance has the staffing to review only a tiny fraction of earnings statements filed by public companies, and until this year it has been swamped by the huge crush of technology initial public offerings of stock. The current crackdown on accounting misdeeds began in mid-1998. The SEC's then-chairman, Arthur Levitt, beefed up policing efforts, approved new auditor-independence rules and issued new accounting guidance to curb bookkeeping practices used to inflate revenue. Last year, the regulator brought 100 financial-fraud actions, and there has been a 28% increase in accounting-related cases in the past three years.

The most visible indicator of improper accounting—and source of new investigations—is the growing number of restated financial reports. Restatements ballooned to 233 last year, twice the number in 1997, according to a recent study by Arthur Andersen LLP. Of those, only 9% resulted from new accounting methods required by the SEC.

Xerox Corp. is an example of the major companies being scrutinized. In recently restating its results for the past three years, Xerox conceded it had "misapplied" a range of accepted accounting rules in a variety of ways, including improperly using a \$100 million reserve to offset unrelated expenses. To correct the reserve error, Xerox cut its 1998 and 1999 pretax profit by \$100 million, while adding \$6 million to 2000's pretax figure. Xerox's acknowledgment of problems hasn't dissuaded the SEC from conducting a broad inquiry into its accounting practices.

Recently, **ConAgra Foods Inc.** said its restatement is the subject of an SEC investigation. ConAgra announced that a subsidiary, which sells seed, fertilizer and chemicals, recorded fictitious sales, among other, accounting possible violations. The company said the revisions would reduce pretax earnings for fiscal 1998, 1999 and 2000 by a total of about \$123 million. For fiscal 2001, the company said its revenue will rise \$350 million.

The pressure to assure maximum compensation, which is tied to share price, is tempting more financial executives to play games to manage earnings—such as recognizing revenue too early or improperly setting up reserves, SEC officials say. Companies fear that missing Wall Street's quarterly earnings targets even by a few pennies can send a stock price tumbling.

The accounting industry argues that the number of restatements and accounting-fraud cases is minuscule as a percentage of the 13,000 public companies that file annual financial reports. But regulators believe the accounting violations may be even more pervasive than the statistics suggest.

"Is it an ice cube or an iceberg?" said Lynn Turner, the SEC's chief accountant. "There's definitely something there below the water line."

The SEC relies on the press, company whistleblowers and its investigators for leads. While the regulator investigates most alleged frauds after word of a company's accounting problems has leaked and battered its stock price, SEC accountants are focusing on ferreting out questionable accounting in financial statements earlier.

With the cooling of the IPO market, the SEC is using its freed-up resources to ramp up its review of annual financial reports. During the fiscal year ended Sept. 30, 2000, the SEC reviewed about 1,100 of the 13,000 annual reports filed on form 10K with the agency, or about eight of every 100. This year's goal: one of every four annual reports.

"The commission's resources have been absorbed during the last two years by the hot IPO market, leaving little time for more random selection of annual reports and other filings," said Robert Bayless, the division's chief accountant.

Accounting-fraud cases, which typically take at least a couple of years to prepare, often rest on complicated and hard-to-prove allegations. The largest cases are handled by the SEC's special accounting-fraud unit staffed by eight attorneys and seven forensic accountants. An additional 60 accountants in Washington and the regional offices also work on cases. Because of limited resources, the SEC doesn't pursue scores of less-egregious cases involving violations caused by negligence.

Rep. John LaFalce (D., N.Y.), ranking member of the House financial-services committee, said recently that his panel will look into the accounting-fraud issue and has called for a 200% to 300% increase in the SEC's enforcement staff to bolster oversight. Such an increase would boost the SEC's total \$423 million annual budget this year by as much as \$400 million.

Critics also complain that the SEC would also be less burdened if the accounting industry did a better job of policing auditors, ostensibly the first line of defense in the fight against fraud. Last year, the SEC worked with industry groups to improve self-regulation and the disciplinary peer-review process, but progress has been slow.

At the request of Rep. John Dingell, (D., Mich.) the General Accounting Office, an independent research arm of Congress, has agreed to study whether the various accounting regulatory groups should be replaced by one full-time self-regulatory organization.

Jonathan Weil contributed to this article.

CONGRESS OF THE UNITED STATES
HOUSE OF REPRESENTATIVES
January 17, 2001

The Honorable DAVID M. WALKER
Comptroller General
U.S. General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

DEAR MR. WALKER: In September 1996, the General Accounting Office (GAO) released a seminal two-volume report, *The Accounting Profession—Major Issues: Progress and Concerns* (GAO/AIMD-96-98), in response to my request concerning the status of recommendations made to the accounting profession over the prior two decades by major study groups to improve accounting and auditing standards and the performance of independent audits under the federal securities laws. GAO's principal finding was that, while the accounting profession had been responsive in making changes to improve financial reporting and auditing of public companies, the actions of the profession had not been totally effective. The most significant weaknesses were found in the areas of auditor independence, auditor responsibility for detecting fraud and reporting on internal controls, public participation in standard setting, the timeliness and relevancy of accounting standards, and maintaining the independence of FASB.

Recent events, in particular last year's bitter fight over maintaining auditor independence, suggest that GAO needs to take another look at the accounting profession. The AICPA's move to block funding for the Public Oversight Board (POB) to conduct the special reviews requested by the Securities and Exchange Commission raises a number of troubling questions about the integrity and effectiveness of the profession's current governance system. Critics also contend that the peer review process is too clubby and too slow and that disciplinary actions are inadequate and ineffective. This is difficult to judge since the process is not transparent, thereby compounding the growing suspicions about ineptitude and collusion.

In 1998, the POB appointed a panel of eight members, charging it to thoroughly examine the audit model. In his remarks to the panel at its public hearings, SEC Chairman Levitt asked: "has the accounting profession become so big and complex that perhaps we need a full-time SRO [self-regulatory organization]? Are the alphabet of regulatory bodies... really workable?" The Panel on Audit Effectiveness (the so-called O'Malley Panel) submitted its report and recommendations on August 31, 2000. I am transmitting Chapter 6—Governance of the Auditing Profession, and requesting that GAO answer Chairman Levitt's question by reviewing the current governance structure, the Panel's proposed system of governance (which appears to call for retention of the current list of entities reporting to an enhanced POB), the status of the profession's response to the Panel's recommendations, and the likelihood that the reforms, if implemented, will be effective.

This is a matter of great importance affecting the reliability of financial statements, and I thank you for your prompt attention to my request.

Sincerely,

JOHN D. DINGELL
Ranking Member

Enclosure

cc: The Honorable W. J. "Billy" Tauzin, Chairman
Committee on Energy and Commerce

GENERAL ACCOUNTING OFFICE
May 23, 2001

The Honorable JOHN D. DINGELL
Ranking Member
Committee on Energy and Commerce
United States House of Representatives

Subject: Auditing Profession's Governance System

DEAR MR. DINGELL: We previously met with your staff to gain a further understanding of your needs concerning your request for a GAO study of the auditing profession's governance system. It was agreed that we would proceed with a design phase given the number of components of the auditing profession's governance system and the broad range of the Panel on Audit Effectiveness' recommendations affecting the governance system. A design phase will enable us to obtain a more complete understanding of the governance system and will allow for the time we will need to access the various senior representatives of each of the system components. The purpose of this letter is to set forth the study objectives and provide you with a completion date for the design phase. We agreed with your staff that the overall objectives of our work will be to:

- obtain an understanding of the structure and operation of the auditing profession's current governance system;
- obtain an understanding of the governance system proposed by the Panel on Audit Effectiveness and how it addresses limitations identified by the Panel;
- determine whether the Panel's recommendations have been accepted, how the system components are working together to implement reforms, their current status, and timeframe for implementation; and
- obtain views of the Panel and senior representatives of each system component regarding critical factors to successful implementation of recommended reforms and any gaps in the recommended reforms.

The design phase will be completed by August 2001. We will remain in contact with your staff, and at the end of the design phase, we will provide you with a projected completion date for the total study. If you should have any questions, please contact Cheryl Clark at (202) 512-9377 or clarkce@gao.gov, or Robert Gramling at (202) 512-6535 or gramlingr@gao.gov.

Sincerely yours,

JEFFEY C. STEINHOFF
Managing Director, Financial Management and Assurance

U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON ENERGY AND COMMERCE
June 7, 2001

The Honorable DAVID M. WALKER
Comptroller General
U.S. General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

DEAR MR. WALKER: I am writing to acknowledge receipt of your letter of May 23, 2001, agreeing to my January 17, 2001, request for a General Accounting Office (GAO) study of the auditing profession's governance system. I am generally comfortable with both your study objectives—some specific comments are set forth below—and the August 2001 timetable for completion of the design phase of GAO's work.

Under my chairmanship, the Committee on Energy and Commerce's Subcommittee on Oversight and Investigations held over 30 hearings on the accounting profession. The GAO's two-volume 1996 report, *The Accounting Profession* (GAO/

AIMD-96-98), prepared in response to my March 1994 request, remains one of the most-requested reports in GAO history and has made a major contribution to the public debate on important accounting issues. Therefore, I retain my interest in these matters, despite the fact that the Committee on Energy and Commerce no longer has a direct role in them. As you know, a recommendation by House Rules Committee Republicans and the House GOP Conference to shift most of the Committee on Energy and Commerce's historic jurisdiction over securities and exchanges to a newly created Financial Services Committee was narrowly approved by the House earlier this year. I believe that decision was unwise, but these important responsibilities have been shifted. Therefore, I am copying the Chairman and Ranking Member of the Financial Services Committee on this letter as I am sure that they will be interested in your report. On January 20, 2001, Speaker Hastert inserted in the *Congressional Record* at H67 a memorandum of understanding (MOU) to clarify this jurisdictional situation. Among other things, the MOU spells out that the Committee on Energy and Commerce will retain jurisdiction over the issue of the setting of accounting standards by the Financial Accounting Standards Board, thus requiring the two committees to work closely on accounting issues and ensuring that the Energy and Commerce Committee's considerable expertise will continue to be brought to bear on these issues.

While I am satisfied with the general objectives set forth in your letter, I also request that these specific critical issues be addressed in your report within those objectives:

- The adequacy and effectiveness of the Securities and Exchange Commission's (SEC) oversight of the profession's governance system. *See, e.g.,* enclosed February 9, 2001, letter from SEC Chief Accountant Lynn E. Turner to Public Oversight Board Chairman Charles A. Bowsher.
- The adequacy and effectiveness of the response of the governance system to the recent string of major accounting debacles, using Livent, Waste Management, MicroStrategy, Cendant, Sunbeam, Rite Aid, and Xerox as case studies.
- The adequacy and effectiveness of the response of the governance system to the sharp increase in misleading and fraudulent accounting. Please update your February 4, 2000 letter report, Review of Reporting Under Section 10A. Given the level of accounting chicanery in the five years since 10A went into effect (1996), one might expect auditor's fraud reports to be piling up at the SEC. However, GAO reported that only six such reports had been filed through December 14, 1999. Are auditors still missing in action?
- The adequacy and effectiveness of the response of the governance system to complaints that "going-concern" clauses, in which auditors raise substantial doubt about a company's ability to stay in business for at least 12 months, were rare among the dot-com companies that shut down or filed for bankruptcy last year. *See, e.g.,* enclosed article "'Going Concerns': Did Accountants Fail To Flag Problems at Dot-Com Casualties?" *Wall Street Journal*, Friday, February 9, 2001. The Financial Services Subcommittee on Capital Markets is conducting an inquiry into the Wall Street shills who passed themselves off as "independent" analysts and how their heavily compromised research and recommendations hurt retail investors—an investigation that I strongly support—but Wall Street analysts are not the only expert sentries who were asleep at their sentry posts or abandoned them altogether.

The adequacy and effectiveness of the response of the governance system with respect to oversight, review, and reporting on the quality control systems that accounting firms are supposed to have implemented to ensure compliance with SEC and firm independence regulations. *See, e.g.,* enclosed article "Opening the Books on Corporate Auditors," *Washington Post*, Sunday, June 3, 2001, on the thorny issues that continue to cast a shadow over the integrity of the profession and its audit function. The SEC's new disclosure requirements are making a tremendous contribution to the public debate on how best to maintain auditor independence in order to safeguard the integrity of our financial reporting system. How has the governance system responded?

Thank you for your cooperation and attention to my request. The importance of this work cannot be overstated. I look forward to hearing back from GAO at the end of its design phase, and I thank you for the significant contribution that GAO makes to the public interest and the protection of investors.

Sincerely,

JOHN D. DINGELL
Ranking Member

Enclosures

cc: The Honorable W. J. "Billy" Tauzin, Chairman

Committee on Energy and Commerce
 The Honorable Michael G. Oxley, Chairman
 Committee on Financial Services
 The Honorable John J. LaFalce, Ranking Member
 Committee on Financial Services

Mr. STEARNS. And now, we welcome our panel: Mr. Edmund Jenkins, who is chairman of Financial Accounting Standards Board; Mr. James Leisenring, member of board, International Accounting Standards Board; and Mr. Barry Rogstad, president of the American Business Conference. And we welcome you gentlemen and we look forward to your opening statement.

Mr. Jenkins?

STATEMENTS OF EDMUND L. JENKINS, CHAIRMAN, FINANCIAL ACCOUNTING STANDARDS BOARD; JAMES J. LEISENRING, BOARD MEMBER, INTERNATIONAL ACCOUNTING STANDARDS BOARD; AND BARRY K. ROGSTAD, PRESIDENT, AMERICAN BUSINESS CONFERENCE

Mr. JENKINS. Thank you, Mr. Chairman, members of the subcommittee.

I am Ed Jenkins and chair of the Financial Accounting Standards Board, or as I like to say it Ms. Harman, the FASB.

I am pleased to be here with you today. I do understand the important oversight role of this subcommittee. And I appreciate the comments that were made by you, Mr. Chairman, and your colleagues this morning about the FASB's independence and the role that we play in our capital markets. That is very important to us.

This morning I plan to discuss the mission and due process of the FASB and our two recently issued financial statements on improving the transparency of the accounting and reporting for business combinations. In addition, I will provide a very brief overview of the FASB's involvement in the area of international accounting standards study. I have very brief prepared remarks, and I would respectfully request that the full text of my statement and all supporting materials be entered in to the record.

Mr. STEARNS. By unanimous consent, so ordered.

Mr. JENKINS. Thank you.

The FASB is an independent organization, as you have recognized, that is funded entirely by the private sector. Our mission is to set accounting and reporting standards to protect the consumers of financial information; most notably investors and creditors. Those consumers rely heavily on credible, transparent and comparable financial information for effective participation in our capital markets.

The FASB's authority with respect to public enterprises comes from the U.S. Securities and Exchange Commission. The SEC has the statutory authority to establish financial accounting and reporting standards for publicly held enterprises, but for over 60 years the SEC has looked to the private sector for leadership in establishing and improving standards.

Because the actions of the FASB effect so many organizations, our decisionmaking process must be thorough. The FASB carefully considers the views of all interested parties: consumers, preparers and auditors of financial information.

Our rules of procedure require an extensive due process that was modeled on the Federal Administrative Procedure Act, but is broader and more open. It involves public meetings, public hearings and exposure of our proposed standards to external scrutiny and public comment. The board makes final decisions only after carefully considering and understanding the views of all parties.

Earlier in July the FASB issued two final statements: number 144 on business combinations and number 142 on goodwill and other intangible assets. The issuance of these two statements is the end result of a public due process that began in 1996, included the issuance of four documents for public comment, over 70 public meetings, 4 days of our own public hearings, company field tests and field visits, and the careful analysis and public discussion of over 600 comment letters received from a broad range of consumers, companies, auditors and other constituents.

Statement 141 will significantly improve the transparency of the accounting and reporting for business combinations by requiring all business combinations to be accounted for under a single method: the purchase method; the use of the pooling of interest method is no longer permitted. The purchase method provides investors with information necessary to determine the true cost of one company buying another. And as a result, it provides a sound basis for consumers to track future returns on that investment.

Statement 142 will improve the purchase method in a number of ways. Most significantly the statement requires that goodwill no longer be amortized to earnings, but instead be tested for impairment. That improvement will provide consumers with greater transparency with respect to the economic value of goodwill and the amount and timing of its impact on companies' earnings.

Another significant development effecting the allocation of FASB resources over the past several years has been the increased attention to the globalization of the financial markets. This has placed heightened interest and emphasis on the quality of international accounting standards and the process for developing those standards. In order for companies from around the globe to share equal access to the capital markets, financial reporting must provide greater comparability and credibility. These issues have underscored the need for a single set of high-quality accounting standards.

A single set of high-quality accounting standards cannot be achieved without first establishing a high-quality global standard-setting structure. Without such a structure, the continued independent process of the various national and international standard setters can only result in increasing divergencies among national financial reporting regimes and between national and international accounting standards.

Since 1997, the FASB has been actively working with other accounting standards, securities regulators and other interested parties around the world to develop such a structure. The result of those efforts has led to the recent creation of the new standard setting body named the International Accounting Standards Board, the IASB. The IASB is based in London. It has a private sector structure and a due process very similar to the FASB. The IASB

began its operations earlier this year and it is currently in the process of establishing its initial agenda.

Mr. Leisenring will comment further on the structure and process of the IASB, I am sure.

For the FASB, we are committed to having a close, constructive and an active relationship with the IASB and with other national standard setters in achieving convergence of high-quality financial reporting standards around the world.

I just want to stop here and emphasize that the key to convergence is high quality. It is not convergence at any cost. It is not convergence to lowest common denominator. And it is certainly not convergence to diluting the quality of the standards we have at the present time in the United States.

We plan on working in partnership with the IASB in contributing to projects that are international in scope and have important implications for our U.S. constituents.

In closing, I believe that the improved transparency resulting from our new standards on business combinations and the thorough and open due process that the board followed in developing those statements illustrates the benefits and the strengths of independent private sector accounting standard setting. Those benefits and strengths will well serve the FASB and the IAMB too as we work in partnership to develop sound and consistent global standards for the world's capital markets.

For over 28 years the FASB has proven, and will continue to prove, invaluable to the efficiency of the capital markets and to the continued confidence of investors and creditors; the consumers of financial information.

Thank you very much, Mr. Chairman. I very much appreciate this opportunity to be here today, and I would be pleased to respond to questions.

[The prepared statement of Edmund L. Jenkins follows:]

PREPARED STATEMENT OF EDMUND L. JENKINS, CHAIRMAN, FINANCIAL ACCOUNTING STANDARDS BOARD

SUMMARY

On July 20, 2001, the Financial Accounting Standards Board ("FASB" or "Board") issued two final Statements—No. 141, *Business Combinations*, and No. 142, *Goodwill and Other Intangible Assets*.

Statement 141 will significantly improve the transparency of the accounting and reporting for business combinations by requiring that all business combinations be accounted for under a single method—the purchase method. Use of the pooling-of-interests method ("pooling method") is no longer permitted. The purchase method provides investors with the information necessary to determine the true cost of one company buying another and, as a result, provides a basis for investors to track future returns on the investment. Statement 141 requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001.

Statement 142 will improve the purchase method in a number of ways. Most significantly, the Statement requires that goodwill no longer be amortized to earnings, but instead be tested for impairment. That improvement will provide investors with greater transparency with respect to the economic value of goodwill and the amount and timing of its impact on companies' earnings. Statement 142 requires that amortization of goodwill cease upon initial application of the Statement, which, for most companies, will be January 1, 2002.

Mr. Chairman, Members of the Subcommittee, I am Edmund Jenkins, chairman of the Financial Accounting Standards Board. I am pleased to be here today. I understand the important oversight role of this Subcommittee.

This morning I plan to discuss the mission and due process of the FASB and our two recently issued final Statements to improve the transparency of the accounting and reporting for business combinations. In addition, I will provide an overview of the FASB's involvement in the area of international accounting standard setting. I have brief prepared remarks, and I would respectfully request that the full text of my statement and all supporting materials be entered into the public record.

WHAT IS THE FASB AND WHAT DOES IT DO?

The FASB is an independent private-sector organization. We are not part of the federal government and receive no federal funding. We are funded entirely from private-sector sources, primarily voluntary contributions and sales of publications.

Our mission is to establish and improve standards of financial accounting and reporting for both public and private enterprises. Those standards are essential to the efficient functioning of the economy because investors and creditors rely heavily on credible, transparent, and comparable financial information.

The FASB's authority with respect to public enterprises comes from the US Securities and Exchange Commission ("SEC"). The SEC has the statutory authority to establish financial accounting and reporting standards for publicly held enterprises. For over 60 years, the SEC has looked to the private sector for leadership in establishing and improving those standards. Therefore, the FASB may be viewed as an independent private-sector alternative to government regulation.

The focus of the FASB is on consumers—users of financial information such as investors, creditors, and others. We attempt to ensure that corporate financial reports give consumers an informative picture of an enterprise's financial condition and activities and do not color the image to influence behavior in any particular direction.

To quote a February 2000 letter from the Financial Accounting Policy Committee of the Association for Investment Management and Research, the leading organization of investment professionals in the US with over 40,000 members:

The 'lifblood' of United States capital markets is financial information that is: (1) comparable from firm to firm; (2) relevant to investment and financing decisions; (3) a reliable and faithful depiction of economic reality; and (4) neutral, favoring neither supplier nor user of capital, neither buyer nor seller of securities.

The notion of neutrality is a fundamental element of our standard-setting process. The FASB's Rules of Procedure explicitly require that the Board be objective in its decision making to ensure the neutrality of information resulting from its standards.

Neutrality is an essential criterion by which to judge financial reporting standards, because information that is not neutral loses credibility and value. For example, surely, we would all agree there would be little value to Congress or the federal government of purposely altered and manipulated information about the rate of inflation or about unemployment.

Similarly, to create or to tolerate financial reporting standards that bias or distort financial information to favor a particular transaction, industry, or special interest group undermines the proper functioning of the capital markets and impairs investors' capital allocation decisions.

As former SEC Chairman Richard C. Breeden stated in testimony before Congress almost a decade ago:

The purpose of accounting standards is to assure that financial information is presented in a way that enables decision-makers to make informed judgments. To the extent that accounting standards are subverted to achieve objectives unrelated to fair and accurate presentation, they fail in their purpose.

More recently, in an October 1997 speech, former SEC Chairman Arthur Levitt stated:

It is compellingly clear to me that the objectivity and fairness of standards-setting can only be guaranteed if the process is insulated from political agendas, special interests, and bureaucratic convenience. If that independence is compromised, or perceived to be compromised, we would pay a heavy price in declining investor confidence in the markets.

The FASB sets standards only if, in the Board's independent judgment after carefully considering the input from all interested parties, there is a significant need for the standard and the costs the standard imposes are justified by the overall benefits. The objective, and implicit benefit, of issuing an accounting standard is increased credibility and representational faithfulness of financial reporting. However, the value of that improvement to financial reporting is usually impossible to measure and the Board's assessment of an accounting standard's benefit to companies

that prepare financial reports and to investors and creditors that use financial reports is unavoidably subjective.

The US capital markets are the deepest, most liquid, and most efficient markets in the world. The unparalleled success and competitive advantage of the US capital markets are due, in no small part, to the high-quality and continually improving US financial accounting and reporting standards. As Federal Reserve System Chairman Alan Greenspan stated in a June 4, 1998 letter to former SEC Chairman Levitt:

Transparent accounting plays an important role in maintaining the vibrancy of our financial markets... An integral part of this process involves the Financial Accounting Standards Board (FASB) working directly with its constituents to develop appropriate accounting standards that reflect the needs of the marketplace.

WHAT PROCESS DOES THE FASB FOLLOW IN DEVELOPING ACCOUNTING STANDARDS?

Because the actions of the FASB affect so many organizations, its decision-making process must be thorough. The FASB carefully considers the views of all interested parties—consumers, preparers, and auditors of financial information. Our Rules of Procedure require an extensive due process that was modeled on the Federal Administrative Procedure Act, but it is broader and more open in several ways. It involves public meetings, public hearings, and exposure of our proposed standards to external scrutiny and public comment. The Board makes final decisions only after carefully considering and understanding the views of all parties.

The FASB's due process for developing a new financial reporting standard is best illustrated by describing the process followed in developing Statements 141 and 142:

- Following the Board's extensive agenda decision process, we decided to add the project on business combinations to the Board's technical agenda in 1996. (Attachment 2 includes a detailed description of how topics are added to the FASB's technical agenda.)
- When we began the project in 1996, we established a business combinations task force comprising individuals from a number of organizations representing a wide range of the Board's constituents. (Attachment 13 lists the members and their affiliations.) The first public meeting of the task force was held in February 1997.
- In June 1997, we published for public comment a Special Report that contained some of the Board's initial tentative decisions about the project's scope, direction, and content. We received 54 comment letters in response to the Special Report.
- In November 1998, we held a second public business combinations task force meeting to discuss issues related to the project.
- In December 1998, we published for public comment, in participation with other members of an international organization consisting of representatives from the accounting-standard-setting bodies of Australia, Canada, New Zealand, the United Kingdom, and the International Accounting Standards Committee ("IASC") (collectively the "G4+1"), a Position Paper that addressed a number of issues related to the methods of accounting for business combinations. We received 148 comment letters in response to the G4+1 Position Paper.
- From 1996 through 1999 we held over 40 public meetings to address the issues associated with the methods of accounting for business combinations and the accounting for goodwill and other purchased intangible assets and to consider constituent comments.
- After each meeting, we updated a summary of all of the Board's decisions. The updated summary was available on the FASB website and was sent by mail to anyone who requested it.
- Our weekly newsletter, *Action Alert*, announced each meeting in advance and reported a summary of the results of each meeting. (In addition, press reports of some of the meetings were available in certain business publications.)
- In September 1999, we published for public comment an Exposure Draft that contained proposed changes to the existing standards of accounting for business combinations and intangible assets. We received approximately 200 comment letters in response to the 1999 Exposure Draft.
- In connection with the issuance of the 1999 Exposure Draft, we prepared and issued a number of explanatory documents to assist constituents in understanding the Board's proposed decisions including a FASB Viewpoints, *Why Eliminate the Pooling Method?* (Attachment 6). All of the documents were available on the FASB website and were sent by mail to anyone who requested them.

- We held four days of public hearings in February 2000 (two days in San Francisco and two days in New York City) to discuss the 1999 Exposure Draft with interested parties. More than 40 individuals and organizations testified.
- In March 2000, we held a third public business combinations task force meeting to discuss issues raised by constituents in the comment letters and public hearings.
- In October and November 2000, we conducted field visits with 14 companies in a variety of industries to discuss a goodwill impairment approach developed by the FASB staff in response to constituent input.
- In November 2000, we held a fourth public business combinations task force meeting to discuss the results of the field visits and the potential need for issuance of a revised Exposure Draft proposing changes to the 1999 Exposure Draft's provisions for accounting for goodwill.
- We held over 15 public meetings during 2000 to consider constituent input received in response to the 1999 Exposure Draft.
- In February 2001, we published for public comment a revised Exposure Draft that contained proposed changes to the 1999 Exposure Draft's provisions for accounting for goodwill. We received approximately 200 comment letters in response to the 2001 revised Exposure Draft.
- In connection with the issuance of the 2001 revised Exposure Draft, we prepared and issued to the public a FASB Viewpoints, *Why Did the Board Change Its Mind on Goodwill Amortization?* (Attachment 9). The document was available on the FASB website and was sent by mail to anyone who requested it.
- We held over 10 public meetings during 2001 to address the issues raised by constituents in response to the 2001 revised Exposure Draft and to continue to address issues raised by constituents in response to the 1999 Exposure Draft.
- In May 2001, the Board completed its public deliberations of all the substantive issues raised by constituents in response to both the 1999 Exposure Draft and the 2001 revised Exposure Draft. The Board reviewed the entire package of decisions made in connection with its public deliberations and unanimously supported the issuance of two final Statements—Statements 141 and 142, replacing Accounting Principles Board (“APB”) Opinion No. 16, *Business Combinations* (“Opinion 16”), and APB Opinion No. 17, *Intangible Assets* (“Opinion 17”), respectively.
- In June 2001, we issued the FASB's monthly newsletter, Status Report, which included an article entitled *Conversations with Constituents*. The purpose of the article was to provide constituent perspectives on the impact of Statements 141 and 142. In addition, the FASB website contained up-to-date details of all of the Board's significant decisions to be contained in the two Statements.
- In July 2001, the Board issued Statements 141 and 142 to the public.

WHAT WAS WRONG WITH THE ACCOUNTING FOR BUSINESS COMBINATIONS?

Prior to the issuance of Statements 141 and 142, the accounting for business combinations was governed by the requirements of Opinions 16 and 17, which were issued in 1970 by the APB, a former standard-setting group of the American Institute of Certified Public Accountants.

Under Opinion 16, business combinations were accounted for using one of two methods, the pooling method or the purchase method. Use of the pooling method was required whenever 12 criteria were met; otherwise, the purchase method was to be used. Because those 12 criteria did not distinguish economically dissimilar transactions, business combinations that were similar were accounted for using different methods that produced dramatically different financial statement results. Consequently:

- Analysts and other consumers of financial statements indicated that it was difficult to compare the financial results of companies because different methods of accounting for business combinations were used.
- Because intangible assets are an increasingly important economic resource for many companies and are an increasing proportion of the assets acquired in many business combinations, consumers of financial statements also indicated a need for better information about those assets. While the purchase method recognizes all intangible assets acquired in a business combination (either separately or as goodwill), only those intangible assets previously recorded by the acquired entity are recognized when the pooling method is used.
- Company managements indicated that the differences between the pooling and purchase methods of accounting for business combinations affected competition in markets for mergers and acquisitions.

Under Opinion 17, all intangible assets acquired in a business combination, including goodwill, were required to be amortized or charged to earnings over the useful economic life of the asset. Consumers, including analysts and other users of financial statements, as well as company managements, noted that intangible assets, including goodwill, are an increasing proportion of the assets acquired in many transactions. As a result, better information about those assets was needed. Consumers of financial statements also indicated that they did not regard goodwill amortization expense as being useful information in analyzing investments.

WHAT DO STATEMENTS 141 AND 142 REQUIRE?

The provisions of Statements 141 and 142 reflect a significantly different approach to the accounting for business combinations than was taken in Opinions 16 and 17. The most significant of those changes are:

- Statement 141 requires that all business combinations be accounted for by a single method—the purchase method. Thus all business combinations will be accounted for in the same way that other asset acquisitions are accounted for—based on the values exchanged.
- In contrast to Opinion 16, which required separate recognition of intangible assets that can be identified and named, Statement 141 requires that intangible assets be recognized as assets apart from goodwill if they meet one of two criteria—the contractual-legal criterion or the separability criterion. To assist in identifying acquired intangible assets, Statement 141 also provides an illustrative list of intangible assets that meet either of those criteria.
- In addition to the disclosure requirements in Opinion 16, Statement 141 requires disclosure of the primary reasons for a business combination and the allocation of the purchase price paid to the assets acquired and liabilities assumed by major balance sheet caption. When the amounts of goodwill and intangible assets acquired are significant in relation to the purchase price paid, disclosure of other information about those assets is required, such as the amount of goodwill by reportable segment and the amount of the purchase price assigned to each major intangible asset class.
- Acquiring companies usually integrate acquired companies into their operations, and thus the acquirers' expectations of benefits from the resulting synergies usually are reflected in the premium that they pay to acquire those companies. However, the transaction-based approach to accounting for goodwill under Opinion 17 treated the acquired entity as if it remained a stand-alone entity rather than being integrated with the acquiring entity; as a result, the portion of the premium related to expected synergies (goodwill) was not accounted for appropriately. Statement 142 adopts a more aggregate view of goodwill and bases the accounting for goodwill on the units of the combined entity into which an acquired entity is integrated (those units are referred to as reporting units).
- Opinion 17 presumed that goodwill and all other intangible assets were wasting assets (that is, finite lived), and thus the amounts assigned to them should be amortized in determining net income; Opinion 17 also mandated an arbitrary ceiling of 40 years for that amortization. Statement 142 does not presume that those assets are wasting assets. Instead, goodwill and intangible assets that have indefinite useful lives will not be amortized but rather will be tested at least annually for impairment. Intangible assets that have finite useful lives will continue to be amortized over their useful lives, but without the constraint of an arbitrary ceiling.
- Previous standards, including Opinion 17, provided little guidance about how to determine and measure goodwill impairment; as a result, the accounting for goodwill impairments was not consistent and not comparable and yielded information of questionable usefulness. Statement 142 provides specific guidance for testing goodwill for impairment. Goodwill will be tested for impairment at least annually using a two-step process that begins with an estimation of the fair value of a reporting unit. The first step is a screen for potential impairment, and the second step measures the amount of impairment, if any. However, if certain criteria are met, the requirement to test goodwill for impairment annually can be satisfied without a remeasurement of the fair value of a reporting unit.
- In addition, Statement 142 provides specific guidance on testing intangible assets that will not be amortized for impairment and thus removes those intangible assets from the scope of other impairment guidance. Intangible assets that are not amortized will be tested for impairment at least annually by comparing the fair value of those assets with their recorded amounts.

- Statement 142 requires disclosure of information about goodwill and other intangible assets in the years subsequent to their acquisition that was not previously required. Required disclosures include information about the changes in the carrying amount of goodwill from period to period (in the aggregate and by reportable segment), the carrying amount of intangible assets by major intangible asset class for those assets subject to amortization and for those not subject to amortization, and the estimated intangible asset amortization expense for the next five years.

HOW WILL STATEMENTS 141 AND 142 IMPROVE FINANCIAL REPORTING?

The changes to accounting for business combinations required by Statements 141 and 142 will significantly improve financial reporting for the benefit of the public—investors, creditors, and other consumers of financial statements—as well as companies that prepare and audit those reports. More specifically, application of Statements 141 and 142 will result in financial statements that:

- *Better reflect the investment made in an acquired entity*—the purchase method records a business combination based on the values exchanged, thus, consumers are provided information about the total purchase price paid to acquire another company, which allows for more meaningful evaluation of the subsequent performance of that investment. Similar information is not provided when the pooling method is used.
- *Improve the comparability of reported financial information*—all business combinations are accounted for using a single method, thus, consumers are able to compare the financial results of companies that engage in business combinations on an apples-to-apples basis. That is because the assets acquired and liabilities assumed in all business combinations are recognized and measured in the same way regardless of the nature of the consideration exchanged for them.
- *Provide more complete financial information*—the explicit criteria for recognition of intangible assets apart from goodwill, the required nonamortization and impairment testing for goodwill and certain intangible assets, and the expanded disclosure requirements provide consumers with more information about the assets acquired in business combinations. That additional information should, among other things, provide consumers with a better understanding of the resources acquired and the expectations about and changes in those resources over time, and improve their ability to assess future profitability and cash flows.
- *Reduce certain transaction costs*—requiring the purchase method of accounting for all business combinations reduces the costs incurred by companies in positioning themselves to meet the criteria for using the pooling method, such as the monetary and nonmonetary costs of taking actions they might not otherwise have taken or refraining from actions they might otherwise have taken.

WHEN DO COMPANIES HAVE TO BEGIN FOLLOWING THE REQUIREMENTS OF STATEMENTS 141 AND 142?

The provisions of Statement 141 apply to all business combinations initiated after June 30, 2001. Statement 141 also applies to all business combinations accounted for using the purchase method for which the date of acquisition is July 1, 2001, or later.

Statement 141 does not apply, however, to combinations of two or more not-for-profit organizations, the acquisition of a for-profit company by a not-for-profit organization, and combinations of two or more mutual enterprises. All of those combinations are being considered in a separate Board project.

The provisions of Statement 142 are required to be applied starting with fiscal years beginning after December 15, 2001. Early adoption is permitted for companies with fiscal years beginning after March 15, 2001, provided that the first interim financial statements have not previously been issued. Statement 142 is required to be applied at the beginning of a company's fiscal year and to be applied to all goodwill and other intangible assets recorded in its financial statements at that date.

There is one exception to the date at which Statement 142 becomes effective: Goodwill and intangible assets acquired by companies after June 30, 2001, will be subject immediately to the nonamortization and amortization provisions of Statement 142.

WHAT IS THE FASB'S INVOLVEMENT IN INTERNATIONAL ACCOUNTING STANDARD SETTING?

Among the significant developments affecting the FASB over the past several years has been the increased attention to the globalization of the financial markets.

This has placed heightened interest and emphasis on the quality of international accounting standards and the process for developing those standards. In order for companies from around the globe to share equal access to the capital markets, financial reporting must provide greater comparability and credibility. These issues have underscored the need for a single set of high-quality accounting standards.

In 1999, the FASB and our parent entity the Financial Accounting Foundation ("FAF") published a report, *International Accounting Standard Setting: A Vision for the Future* (the "FAF-FASB Vision") (Attachment 14). The FAF-FASB Vision identified the establishment of a high quality global standard-setting structure as essential to the future success of a truly international financial reporting system in which a single set of accounting standards could be used world-wide. Without such a structure, the continued independent processes of the various national and international standard setters would only result in increasing divergences among national financial reporting regimes and between national and international accounting standards. That would increase the difficulties of meeting market demands for international comparability. Continued differences would augment the risks and uncertainties surrounding cross-border investment opportunities and would raise questions about the relative quality of one set of standards compared to another.

In its vision, the FASB identified the restructuring of the existing London-based international accounting standard setter, the IASC, as one way in which a quality global standard setter might be established. The IASC had begun the process of reorganizing itself to create a new global standard-setting structure in 1997. It appointed a Strategy Working Party ("SWP") to develop the IASC's strategy and structure. That SWP included a FASB member and an FAF trustee. In November 1999, the SWP published a report, *Recommendations on Shaping IASC for the Future*, which was unanimously supported by the IASC board. The recommendations describe a private sector structure with many of the characteristics of the existing FAF-FASB structure and in many ways consistent with the ideal structure described in the FAF-FASB Vision.

In December 1999, the IASC began implementing the SWP's recommendations. In May 2000, the IASC established a group of trustees responsible for overseeing a new standard-setting body, named the International Accounting Standards Board ("IASB"). In January 2001, the IASC trustees selected the initial members of the IASB. Two members of the IASC trustees are or were members of the FAF trustees, and two members of the IASB are former members of the FASB. One of those members will be responsible for maintaining liaison between the FASB and the IASB.

While the FASB's primary focus has always been and will continue to be on US accounting standards, it has for many years been an important contributor to the convergence of international accounting standards. The business combinations project resulting in the issuance of Statements 141 and 142 is the most recent example of our continued support of that effort. The Accounting Standards Board ("AcSB") of the Canadian Institute of Chartered Accountants has been conducting a project on business combinations concurrently with the FASB project with the goal of converging North American accounting standards related to business combinations. The AcSB will soon issue final standards that prohibit the use of the pooling method and are similar in most other material respects with Statements 141 and 142.

During the past year, the FASB also continued to support the convergence effort through our participation in the G4+1. Carrying on its mission of encouraging dialogue and collaboration among participating nations, the G4+1 published two reports last year. The first was on a new approach to lease accounting and the second focused on share-based payments. Following the recent formation of the IASB, the G4+1 disbanded in anticipation that much of its past work will be addressed in the future through the IASB.

Yet another example of FASB participation in the global accounting arena over the past year was the December 2000 publication of a Special Report on the fair value of financial instruments. The Special Report was published in collaboration with several national standard setters from around the globe and the IASC that were brought together through a Joint Working Group of standard setters. The Special Report recommends far-reaching changes to accounting practices for financial instruments and similar items, including measurement of virtually all financial instruments at fair value and the elimination of special accounting for instruments used in hedging relationships.

As the FASB participates in the critical task of developing sound and consistent global standards, we look forward to a close, constructive and active relationship with the IASB and other national standard setters in achieving convergence of high quality financial reporting standards around the world. We are particularly pleased that two former FASB members are members of the IASB. (Attachment 15 is an

interview with the two former FASB members discussing their perspectives on the IASB). We plan on continuing to work in partnership with the IASB and contributing to projects that are international in scope and have important implications for our US constituents.

In closing, I believe the improved transparency that will result from Statements 141 and 142, and the thorough and open due process that the Board followed in developing those Statements, illustrates the benefits and the strengths of independent private sector accounting standard setting. Those benefits and strengths will well serve the FASB and the IASB as we work in partnership to develop sound and consistent global standards for the world's capital markets. For over 28 years the FASB has proven, and will continue to prove, invaluable to the efficiency of the capital markets and to the continued confidence of investors—the consumers of financial information.

Thank you, Mr. Chairman. I very much appreciate this opportunity and would be pleased to respond to any questions.

[Additional material submitted is retained in subcommittee files.]

Mr. STEARNS. Thank you, Mr. Jenkins.

Mr. Leisenring?

STATEMENT OF JAMES J. LEISENRING

Mr. LEISENRING. Good morning, Mr. Chairman.

Mr. STEARNS. Good morning.

Mr. LEISENRING. And members of the subcommittee.

My name is Jim Leisenring and I am a member of the International Accounting Standards Board, IASB. My specific responsibilities with the IASB includes serving as that board's liaison board member for the Financial Accounting Standards Board, or FASB.

I have submitted to you information concerning the organizational structure of the IASB, together with a list of trustees of the foundation and the membership of the IASB advisory group's Standards Advisory Council. I would respectfully request that those materials be submitted to the subcommittee that I submitted to be part of the official hearing.

Mr. STEARNS. By unanimous consent, so ordered.

Mr. LEISENRING. Thank you.

And you will note, in looking at those materials, that the structure and the board's required due processes are very similar to those required by the FASB, though they are not identical.

As you are probably aware, the IASB has been in the process of getting organized, primarily focusing on attracting a technical staff and analyzing potential agenda projects. Our staffing is essentially complete, and over the next few weeks those who have agreed to work for the IASB will become available to begin the staff work on the initial agenda projects.

Efforts of the IASB are expected to be in cooperation with various domestic standard setting organizations including, of course, the FASB. The FASB has been very generous in sharing their expertise and particularly helpful to the IASB. These efforts are widely recognized around the world, and I believe very much appreciated.

The cooperation between the IASB and the FASB should be expected because we have a shared objective: the creation of a single set of accounting standards suitable or useful domestically and internationally.

While each board must reach their own conclusion on the issues addressed, with appropriate procedures in place it is anticipated we

will be able to substantially converge accounting standards. I must emphasize a point that Mr. Jenkins made, however, the convergence must not be accomplished by the search for the lowest common denominator, but rather a search for superior standards. As a result, financial reporting would improve internationally and in domestic jurisdictions as well.

I thank you for your interest in the IASB and in inviting me to this hearing. I am confident the IASB will also, in time, earn the high esteem in which you hold the FASB. I look forward to responding to your questions.

[The prepared statement of James J. Leisenring follows:]

PREPARED STATEMENT OF JAMES J. LEISENRING, MEMBER OF THE BOARD,
INTERNATIONAL ACCOUNTING STANDARDS BOARD

Mr. Chairman, Members of the Subcommittee, I am James J. Leisenring, a Member of the Board of the International Accounting Standards Board ("IASB") and the IASB's liaison to the Financial Accounting Standards Board.

I have a brief oral statement, and I would respectfully request that my (attached) supporting materials submitted to the Subcommittee be made a part of the official hearing record.

Thank you, Mr. Chairman. I would be happy to respond to any questions.

Mr. STEARNS. I thank the gentlemen.
Mr. Rogstad, your opening statement?

STATEMENT OF BARRY K. ROGSTAD

Mr. ROGSTAD. Thank you, Mr. Chairman, members of the subcommittee.

I am Barry Rogstad, president of the American Business Conference. ABC is a nonpartisan coalition of mid-size chief executives of a fast-growing companies. And before coming to ABC, I served as chief economist and managing partner of strategic international consulting services for Coopers & Lybrand.

I congratulate the subcommittee for holding this hearing. Oversight of the FASB is a wholly legitimate responsibility to the Congress. Congress created the SEC and charged the commission with the setting of accounting standards. The SEC in turn endowed the FASB with operational responsibilities for setting those standards. Thus there is a chain of accountability emanating from Congress through the SEC to the FASB. I find the critics of congressional oversight of the FASB forget this important fact and I think it needs to be stated.

I think, to be sure, past Congresses have not always exercised the oversight authority with much vigor. That is because the FASB typically has acted in ways that have not carried much political urgency. That has changed. Looking ahead, I think it is safe to say that the subcommittee can anticipate exercising its oversight authority with ever greater diligence as more and more Americans invest in the equities markets and as the changing nature of the international economy forces the FASB to address highly controversial issues such as stock options accounting under the rubric of international accounting harmonization.

Now for the purposes of today's hearing, I was asked to focus my testimony to an evaluation of the effectiveness of the FASB process with respect to the recently concluded business combinations and intangible assets project.

The members of the American Business Conference have a long-standing interest in the health and stability of the Nation's capital market. Central to their successful performance is the private sector standard-setting process of which the FASB is the central custodian. This process has served our Nation well, and the focus of all participants in the capital market should be on its continued viability.

The ABC has had significant involvement with the FASB on numerous issues. Since Mr. Ed Jenkins became FASB chairman, we have sustained a dialog on the broader FASB agenda as well as the business combination project. It is from all of these discussions that I draw my testimony this morning.

The stated mission of the FASB, as Mr. Jenkins has just said, is to establish and improve standards of financial accounting and reporting for the guidance in education of the public, including issuers, auditors and users of financial information.

This challenging task is made more daunting by the increased emphasis in our economy on intangible assets and the acknowledged inadequacy of the traditional historical cost accounting model to capture today's business and economic reality.

There is also one other important change impacting the FASB process. With 50 percent of households now equity owners in American businesses, Main Street and Wall Street have become closely aligned. This growing constituency of users of financial statements understands the significance of accounting standards on the performance of financial markets. This has important ramifications for the FASB and the Congress. Confronted with this reality, FASB will find it increasingly difficult to separate its deliberations from any public policy considerations. The Congress, for its part, will face increased pressure to intervene and move beyond its traditional oversight role.

Strengthening the FASB process is essential, from my perspective, if for no other reason than to ensure these two external forces are properly addressed. My view of the role of FASB is one of consensus-builder across the users of financial statements. The board has a responsibility to put forward a proposed standard and the reasons underlying the required changes. It then seeks views of interested party and uses these views to evolve a position that represents the best possible technical accounting and business judgment. Achieving the broadest possible consensus across the dominant viewpoints is essential to the ultimate acceptance and utility of the finalized standards.

The FASB process, as it applied to the business combinations project, in my judgment, did not perform well. We wrote a number of memorandums on these observations during the conduct of the project throughout the process. In our judgment, FASB reached interim conclusions that to the objective reader of the record could not be justified. Lack of transparency in the process generated significant frustrations among user groups; in particular, many of us in the business community. Given our perception of FASB's intransigence, I am talking about the middle of this project now, we reluctantly initiated discussions with Members of Congress responsible for congressional oversight of the FASB. This action led to a letter of concern from 10 members of the Senate and the introduc-

tion of legislation in the House calling for a moratorium on the FASB project.

It is important to emphasize to this committee the degree of discomfort that I personally felt about involving the Congress in this issue. We felt the FASB process had broken down and the only recourse was through a congressional oversight function. The acknowledged danger of our action was the potential for congressional involvement in the standard-setting process itself.

Faced with these circumstances, it was important for the FASB to reconsider its position. To its credit, it initiated steps designed to achieve what I referred to throughout the process as a win-win outcome; a win for the FASB meant a standard that conforms to sound technical accounting basis and addressed the requirements of all users of financial statements, a win for users in general and the business community in particular meant a standard that correctly portrayed business in economic reality and facilitated efficient and effective reporting.

FASB did reconsider its position. It now appears the results of the project have achieved the desirable win-win results. Much of the credit goes to Chairman Jenkins for his management skills and willingness to reconsider positions already taken.

FASB's response focused on consideration of a major change to purchase accounting methodology: the substitution of an impairment approach to goodwill in place of required use of fixed appreciation schedules. This was a major breakthrough and, because it was controversial, required courage on the part of the FASB.

I was privileged to be part of the team that met with FASB last September to discuss the proposed impairment test that would apply to goodwill. The FASB expanded this proposal and discussed it with users through interviews and provided another opportunity for user input during the comment period last May.

This impairment approach to accounting for purchased goodwill is a major part of the final standard recently published by the FASB. It represents a technically correct and workable approach to the challenge of how to account for business combinations. FASB is to be congratulated for this breakthrough.

Did the FASB process, as used in the business combinations project, produce a good result? Yes.

Did this experience demonstrate a profound need to strengthen the FASB process itself to ensure successful outcomes in the future? Yes.

And I say that in the sense that I think the process needs to work more routinely. By that I mean it should always rely on extra outside pressure, either from the business community or the Congress. And most importantly a routine process should not require the extraordinary leadership of the chairman.

My major recommendations to the FASB would be to focus on consensus building across user groups. FASB, to its credit, has been attempting to involve users much earlier in the process. This emphasis needs to be continued. Of prime significance, however, is the need for the FASB to document its decision process, showing, in particular, how it balanced technical considerations in the views of interveners in reaching its positions. This process, I believe, requires greater transparency and the sustaining of a dialog until the

necessary consensus is achieved. It was the failure on this issue that led to the breakdown of the process during the business combinations project.

It is clear to this observer that FASB does have the capacity to develop among the users the financial statements generally accepted standards on highly controversial subjects. Based on our experience with the business combinations project, it is also clear that the FASB process needs to be significantly improved. Absent this, in my judgment, FASB will not have sufficient support to always succeed in the long-term.

The stakes are very high and we in the ABC look forward to working with the FASB to ensure that its process continues to produce win-win outcomes in the future.

Thank you, Mr. Chairman.

[The prepared statement of Barry K. Rogstad follows:]

PREPARED STATEMENT OF BARRY K. ROGSTAD, PRESIDENT, AMERICAN BUSINESS CONFERENCE

Mr. Chairman and Members of the Committee.

I am Barry Rogstad, president of the American Business Conference (ABC). ABC is a nonpartisan coalition of chief executives of fast-growing, mid-size companies. Before coming to ABC, I served as chief economist and Managing Partner for International Consulting at Coopers & Lybrand.

I congratulate the Subcommittee for holding this hearing. Oversight of the Financial Accounting Standards Board (FASB) is a wholly legitimate responsibility of Congress. Congress created the Securities and Exchange Commission and charged the Commission with the setting of accounting standards. The SEC, in turn, endowed the FASB with operational responsibility for setting those standards. Thus, there is a chain of accountability emanating from Congress, through the SEC, to the FASB. Critics of Congressional oversight of the FASB forget this important fact.

To be sure, past Congresses have not always exercised the oversight authority with much vigor. That is because the FASB typically has acted in ways that have not carried much political urgency. That has changed. Looking ahead, I think it is safe to say that this Subcommittee can anticipate exercising its oversight authority with ever greater diligence, as more and more Americans invest in the equities markets and as the changing nature of the international economy forces the FASB to address highly controversial issues - such as stock options accounting - under the rubric of international accounting harmonization.

For the purposes of today's hearing, I have been asked to confine my testimony to an evaluation of the effectiveness of the FASB process with respect to the recently concluded project on Business Combinations and Intangible Assets.

The members of ABC have a long-standing interest in the health and stability of the Nation's capital markets. Central to their successful performance is the private sector standard setting process, of which the FASB is the central custodian. This process has served our nation well, and the focus of all participants in the capital markets should be on its continued viability.

The ABC has had significant involvement with the FASB on numerous issues. Since Mr. Ed Jenkins became FASB Chairman, we have sustained a dialogue on the broader FASB agenda as well as the business combination project. These discussions, together with our significant participation in the business combination project form the basis of the remainder of my testimony.

This testimony constitutes my personal views, since time does not permit its formal approval by ABC management. However, I do believe it incorporates the views of the members of the ABC.

The stated mission of the Financial Accounting Standards Board is to establish and improve standards of financial accounting and reporting for the guidance and education of the public, including issuers, auditors, and users of financial information. This challenging task is made more daunting by the increased emphasis in our economy on intangible assets, and the acknowledged inadequacy of the traditional historical cost accounting model to capture today's business and economic reality.

There is also one other important change impacting the FASB process. With fifty percent of households now equity owners in American businesses, Main Street and Wall Street have become closely aligned. This growing constituency of users of fi-

financial statements understands the significance of accounting standards on the performance of financial markets.

This has important ramifications for the FASB and for the Congress. Confronted with this reality, FASB will find it increasingly difficult to separate its deliberations from any public policy considerations. The Congress will face increased pressure to intervene, and move beyond its traditional oversight role. Strengthening the FASB process is essential if for no other reason than to insure these two external forces are properly addressed.

My view of the role of FASB is one of consensus builder across the users of financial statements. The Board has a responsibility to put forward a proposed standard and the reasons underlying the required changes. It then seeks views of interested parties, and uses these views to evolve a position that represents the best possible technical accounting and business judgment. Achieving the broadest possible consensus across the dominant viewpoints is essential to the ultimate acceptance and utility of the finalized standards.

The FASB process as it applied to the Business Combinations Project did not perform well. FASB reached interim conclusions that to the objective reader of the record could not be justified. Lack of transparency in the process generated significant frustrations among user groups, in particular many of us in the business community. Given our perception of FASB intransigence, we reluctantly initiated discussions with members of Congress responsible for Congressional oversight of the FASB. This action led to a letter of concern from ten members of the Senate, and the introduction of legislation in the House calling for a moratorium on the FASB project.

It is important to emphasize to this committee the degree of discomfort I felt about involving the Congress in this issue. The members of ABC as well as my Washington colleagues who were involved in the effort shared that concern. We felt the FASB process had broken down and the only recourse was to the Congressional oversight function. The acknowledged danger of our action was the potential for Congressional involvement in the standard setting process itself.

Faced with these circumstances, it was important for the FASB to reconsider its position. It initiated steps designed to achieve what I referred to throughout the process as a win-win outcome. A win for the FASB meant a standard that conformed to sound technical accounting basis and addressed the requirements of all users of financial statements. A win for users in general, and the business community in particular, meant a standard that correctly portrayed business and economic reality and facilitated efficient and effective reporting.

FASB did reconsider its position. It now appears the results of the project have achieved this desirable win-win result. Much of the credit goes to Chairman Jenkins for his management skills and willingness to reconsider positions already taken.

It was always clear to this observer that FASB wanted to eliminate the pooling of interests approach to accounting for business combinations. If the FASB were to place sole reliance on the purchase accounting option, then it had to be sure that the methodology addressed all of the key technical and operational issues. Merely to list the issues involved indicates the importance of the discussion: goodwill amortization, valuation of intangibles, separation of identifiable intangible assets from goodwill, and the associated effects on reported earnings.

FASB's response focused on consideration of a major change to purchase accounting methodology: the substitution of an impairment approach to goodwill in place of required use of fixed depreciation schedules. This was a major breakthrough and, because it was controversial, required courage on the part of the FASB. I was privileged to be part of a team that met with FASB last September to discuss a proposed impairment test that would apply to goodwill. The FASB expanded this proposal, and discussed it with users through interviews and another opportunity for user input during a comment period in March of this year. ABC together with two of its members, NASDAQ and Grant Thornton, conducted a survey of businesses to provide FASB with as many views as possible.

This impairment approach to accounting for purchased goodwill is a major part of the final standard recently published by the FASB. It represents a technically correct and workable approach to the challenge of how to account for business combinations. FASB is to be congratulated for this breakthrough.

Did the FASB process as used in the business combinations project produce a good result? Yes. Did this experience demonstrate a profound need to strengthen the FASB process to insure successful outcomes in the future? Yes.

My major recommendation to the FASB would be to focus on consensus building across user groups. FASB, to its credit, has been attempting to involve users much earlier in the process. This emphasis needs to be continued. Of prime significance, however, is the need for the FASB to document its decision process showing in par-

ticular, how it balanced technical considerations and the views of interveners in reaching its positions. This process, I believe, requires greater transparency and the sustaining of a dialogue until the necessary consensus is achieved. It was a failure on this issue that led to the breakdown of the process during the business combination project.

It is clear to this observer that the FASB does have the capacity to develop among the users of financial statements generally accepted standards on highly controversial subjects. Based on our experience with the business combinations project it is also clear that the FASB process needs to be significantly improved. Absent this, FASB will not have sufficient support to succeed in the long term.

The stakes are very high. We in the ABC look forward to working with the FASB to insure that its process continues to produce win-win outcomes in the future.

Thank you. I would be pleased to answer any questions.

Mr. STEARNS. I thank you. I will be first with my questions.

Probably the world will little note nor long remember what we say here this morning. With the exception of a few, maybe Ms. Harman, most of us do not have the corporate experience to understand the accounting process. But there has been a lot in the newspapers and most of us have invested in stocks and we rely generally on these accounting procedures and when we talk to the stockbroker, we assume that he is working off the same set of books as other corporations are, so you can compare. But lo and behold, we find out that has not been true and that is why FASB issued its June 27 and July 20, the report came out on dealing with the standards 141 and 142.

Not getting too arcane or esoteric here, I say to my colleagues, this hearing is important because we are trying to say, as Mr. Rogstad has said, 50 percent of Americans are now invested in equities. They are talking to their brokers and their broker has to know if these standards from company to company are meaningful.

So, Mr. Jenkins, the first question is, this is a little past history, a prologue: A company buys another company under the pooling standards and the expense for this company evaporates and they continue to build and the expense to buy evaporates. And so the investor says, "Gee whiz, that company's making money hand over fist." But none of the expenses are showing. So you stepped in and have these new standards 141 and 142.

So my question to you: Tell me today how it is going to differ for company A and B: A buys B and let's say B costs \$10 billion; what happened in the old days and what is going to happen? Is this too new? I know it is too new, but give me some comfort on what is going to happen in the new day where this purchase of \$10 billion is going to show up so that the investor and the broker will say, "Oh, yeah, there is some expense for purchasing this company."

Mr. JENKINS. Thank you, Mr. Chairman, I will be happy to try to respond to that.

Mr. STEARNS. Very, you know, you have to make it very layman oriented.

Mr. JENKINS. The key is the investment that one company makes in another when they acquire it.

Mr. STEARNS. Right.

Mr. JENKINS. In your example company A acquires company B and company A used \$10 billion worth of consideration to buy company B.

Mr. STEARNS. Right.

Mr. JENKINS. Under the old pooling of interest method, the company that was bought would not be recorded as an investment at \$10 million, it would be recorded at whatever company B had shown on its books.

Mr. STEARNS. What its book value was.

Mr. JENKINS. What its book value was. And let's say it was \$500 million.

Mr. STEARNS. Right.

Mr. JENKINS. If we have an example that was like that.

Mr. STEARNS. So the rest would be goodwill.

Mr. JENKINS. The rest would not be even goodwill in the pool.

Mr. STEARNS. Nothing.

Mr. JENKINS. It would be nothing.

Mr. STEARNS. Let's see, \$10 billion, now you are down to \$500 million.

Mr. JENKINS. That is about a difference of—

Mr. STEARNS. So you show the expense of \$500 million.

Mr. JENKINS. You would have \$500 million on the company's books and \$9.5 billion would just, kind of, disappear.

Mr. STEARNS. Where would it go? Would it show anywhere?

Mr. JENKINS. Does not get recorded at all under the pooling of interest method. Does not get recorded at all.

Mr. STEARNS. So corporation America has this enormous expansion acquisition program and, lo and behold, maybe 0.5 percent or 1 percent or, you know, very little of it shows up and each company keeps rolling on.

Mr. JENKINS. Yes. The problem is that then this company, the earnings of company B look pretty good when measured against \$500 million, but they might not look quite so good if they were measured against \$10 billion.

Mr. STEARNS. \$10 billion.

Mr. JENKINS. \$10 billion.

Mr. STEARNS. Right.

Mr. JENKINS. So what our new standard does is it does away with this pooling of interest methodology. It says every business combination, every acquisition, regardless of the form of consideration used to acquire it, whether it is stock or cash or debt or whatever, needs to be recorded at the full value of the consideration paid.

Mr. STEARNS. Okay. So if A buys B for \$10 billion, then it has to show the entire \$10 billion as expense.

Mr. JENKINS. Right, and that is where the transparency comes in. That is the transparency we have been looking for; what did you actually put out in consideration for this company? Well, let's reflect this on the financial statements and then subsequent performance can be measured against the totality of that investment rather than some other number.

Mr. STEARNS. Has this procedure of pooling gone back to John D. Rockefeller? Has he been doing it? Did he do it, too?

Mr. JENKINS. No, he did some other things, I think, that maybe we do not need to get into today.

Mr. STEARNS. Right.

Mr. JENKINS. I do not think he used pooling of interest accounting.

Mr. STEARNS. How long has pooling been going on?

Mr. JENKINS. Well, for a long time.

Mr. STEARNS. Ten years? Twenty years?

Mr. JENKINS. No, no. No, no much longer. The standard that we just replaced.

Mr. STEARNS. A hundred years.

Mr. JENKINS. It has been in existence since 1970.

Mr. STEARNS. Okay.

Mr. JENKINS. And it was designed to, the project was designed to approve abuses in pooling of interest accounting that existed at that date.

Mr. STEARNS. And so, Ernst and Young and Pricewaterhouse, all of them accept pooling as a standard procedure; that this huge \$10 billion is an advantage, and they all accepted that as a-okay?

Mr. JENKINS. Well, in their defense, that was the standard and that was required. In fact, if you met certain standards—

Mr. STEARNS. But would not these accounting firms have some kind of feeling, like, "Gee whiz, we just evaporated \$9.5 billion"? Would not they come to you and say, "Gee whiz, this is not right"? 1971, I mean, why did it take so long?

Mr. JENKINS. Well, it took a long time because it was a very controversial subject. Many companies liked the idea of recording the \$500 million instead of the \$10 billion.

Mr. STEARNS. Okay.

Now, let's go to a new problem. It appears, based upon newspaper reports, that corporations are involved with what is called a pro forma approach to accounting; that is, basically, that they are going to provide earnings based upon pro forma and that will show, in some cases, a corporation has a profit. But, lo and behold, when they give the SEC their P&L statement, it shows a loss.

But the pro forma will come out, sometimes it might be printed at the same time, but it will come out 2 or 3 months later. Well, meanwhile, all the stockbrokers look at this profit from company A and say, "Gee whiz, it is making money," so the stock goes up. Whereas a lot of the people who are in the know realize we just had a \$250 million or a \$1 billion loss.

So how did that happen? And is it, in the same sense, that this has just been generally accepted accounting procedures? Or why do not you just take me through that scenario?

Mr. JENKINS. This phenomenon of so-called pro forma earnings is relatively recent. I would say in the last 6 years it has begun.

Mr. STEARNS. Maybe since the dot-com type stuff.

Mr. JENKINS. Yes, and earlier that was certain, kind of, corporate restructuring charges and so on.

The first thing I would like to say is that the presentation of pro forma information, the type your talking about, is not permitted under our standards within the context of financial statements.

Mr. STEARNS. So there are no standards for pro forma reporting in America?

Mr. JENKINS. That is correct, Mr. Chairman.

Mr. STEARNS. Okay. So every corporation can make up their own standards and issue their own report.

Mr. JENKINS. They can.

Mr. STEARNS. Okay.

Mr. JENKINS. And what I think is important is that the earnings and the earnings per share information that comes from generally accepted accounting principles, from our financial reporting standards, is the benchmark.

Mr. STEARNS. Right. That is what the SEC wants to see.

Mr. JENKINS. Right. And that is what shown in this 10-Q.

Mr. STEARNS. When you do a pro forma, does not Ernst and Young and Pricewaterhouse, do they have they have their name on it at all?

Mr. JENKINS. No.

Mr. STEARNS. No. So no one backs up the information except the corporation.

Mr. JENKINS. That is correct.

Mr. STEARNS. Okay.

Mr. JENKINS. And I believe and I think this gets to a similar point that you made in your opening remarks, but I believe that because GAAP reporting is the benchmark, that when pro forma information is presented, that the GAAP information needs to be presented at the same time.

Mr. STEARNS. Simultaneously. So that is your recommendation?

Mr. JENKINS. Yes. So that the difference between the pro forma earnings and the GAAP, the general accepted earnings, are available to all investors or all customers in financial information.

Mr. STEARNS. Well, do you think the average investor or broker is aware that the pro forma report he gets is really something that the corporations make up with no standard accounting procedures? Do you think, I mean, do we need to educate Americans to point out that when you have corporation A say, "We had a profit," that is all based upon their own standards, whereas accepted standards show they had loss, a huge loss? I mean, do we need to get that out or is it known by investors?

Mr. JENKINS. I cannot really speak for all investors, but I think that the idea that I just suggested, and I think it is consistent with yours, of showing this information at the same time.

Mr. STEARNS. At the same time, okay.

Mr. JENKINS. Or at least disclosing the information at the same time in the same place, is, in of itself, an educational process.

Mr. STEARNS. We will probably have a second round. We do not have a lot of members.

What role does the SEC have in the pro forma report? Any?

Mr. JENKINS. The SEC could exercise jurisdiction over, as I understand it, over any type of information that is presented.

Mr. STEARNS. But they do not. They have done no jurisdiction.

Mr. JENKINS. What they have said, to the best of my understanding, is that when you present pro forma information, you should describe how you have computed it.

Mr. STEARNS. Okay. Just quickly, any one of you gentlemen would like to comment on the conversation Mr. Jenkins and I have had, maybe just anything you wish to add?

Mr. LEISENRING. I would add that internationally the problem seems to be increasing. The notion of pro forma earnings seems to be something that America can export. It is probably going to cause the same confusion elsewhere that you are concerned about here.

But I think you have to look very closely at what is attempting to be accomplished.

People are trying to suggest that they want to be measured by a different paradigm than a pool basis accounting earnings under generally accepted accounting principles. There may be some justification for that concern, which is why FASB and others are looking at alternative measures of performance for disclosure and things that might be useful to investors and potential investors.

But the benchmark has and remains to be earnings and I think, increasingly, at least informed investors and their agents, are fairly aware that some of these other presentations are, sort of, earnings before undesirable items or some other paradigm such as that. And, historically, a good many people interested in promulgating that sort of measure have been people that would not have had earnings, as you suggested, under the traditional approach.

But I think we cannot just dismiss it as only shenanigans and look at the deeper cause of the fact that there are some problems.

Mr. STEARNS. I am not even saying, I am just trying to understand.

Mr. LEISENRING. No, I understand.

Mr. STEARNS. I am not saying it is shenanigans, and I am just saying that there might be a legitimate reason for a pro forma. But I say it is confusing and I think that we need some kind of standard so that we can compare what it means.

Mr. LEISENRING. And that is why the FASB, I think, has put a lot of effort over the last few years into attempting to explore those alternative measures.

Mr. STEARNS. Do you have anything, Mr. Rogstad?

Mr. ROGSTAD. I would just add to everything that has just been said two things: No. 1, I think that what users are looking for is to try to figure out what are the earnings from operations of a business. What business are you in?

Mr. STEARNS. What is your turn on investment?

Mr. ROGSTAD. What are the earnings on that business?

There are two other things that influence that that FASB's very much engaged in how you report to it. No. 1 is this whole relationship between the income statement and the balance sheet, which is what intangible assets and this amortization versus impairment test is all about. And second, there is the question, a lot of companies today are reporting positive earnings, the vast majority of which is coming from their investments in other companies as opposed from their own operations. It is pretty important for an investor to delineate those issues. So some of the pressures for pro forma reporting, I think, come from that.

I think I would emphasize, however, it is much more desirable for these issues to be dealt with within the FASB framework. I think that is why the FASB framework, in its continued development, is absolutely important.

Mr. STEARNS. Do you think FASB should oversee this and come up with standards for pro forma?

Mr. ROGSTAD. I think I do agree with that. I think the notion that, in fact, any business can use its own discretion as to the process in which it reports this, the final requirement here is so that users can make comparability decisions across an array of invest-

ments. If we have everybody reporting on a different basis, I think that outcome is not facilitated.

Mr. STEARNS. I appreciate your candid comments. Yes?

Mr. JENKINS. If I may comment, tomorrow at our public board meeting we usually hold every Wednesday, we are going to discuss the scope of two potential projects that bear on this issue. One will be a potential project to look at how we might improve disclosures with respect to intangible assets, intangible assets particularly that are developed internally, like that result from a company's own research and development efforts.

We also are going to consider a separate project that would relate to what I refer to as performance metrics that may not be pro forma earnings in its entirety, but it is things that get at the issue of a company's performance and what might be expected in the future. It is things like quality of product, time to market, backlog, other performance-related issues.

The FASB, as Mr. Leisenring just mentioned, has been working on this area for some time. It really is an outgoing effort of a committee that I chaired back in the early 1990's that issued a report in 1994 called "Business Reporting Model: Focusing On The Information Needs Of Users." And the FASB has earlier this year published this document. It is called "Improving Business Reporting: Insights Into Enhancing Voluntary Disclosures." It calls for more discipline, and yet more voluntary disclosure of performance metrics to supplement financial information.

We also have just issued in April this special report called "Business And Financial Reporting: Challenges From The New Economy" that really focuses on the challenges of providing better information about intangibles.

So we are going to be considering the potential scope of two projects in this area that would clearly bear on these issues that you are raising this morning, Mr. Chairman.

Mr. STEARNS. Thank you. My time has expired. The gentleman from New York?

Mr. TOWNS. Thank you very much, Mr. Chairman.

Mr. Jenkins, I congratulate FASB for the successful completion of its business combinations project. I believe that your process was open and fair, and that the SEC and Congress exercise appropriate oversight. The Finance Subcommittee, on which I served as ranking member, held a hearing on this issue last May.

While most of your constituents are happy with the end results, some questions remains. Let me get to the question.

My question is, could you please explain how the impairment tests will be implemented, and what safeguards have been put in place to make sure that the tests cannot be gamed? Some critics complain that the tests can be used to distort values.

Mr. JENKINS. I will be glad to respond to your question, Congressman.

The impairment tests relies on determining the fair values that are involved in the company's operation. The first step is to decide where this goodwill that you have acquired resides within the various operations of a company. Usually it will reside in one or more operating segment of the company. The FASB standards already

require the disclosure of a significant amount of information about segments, so the basic information is already there and reported publicly, in most cases. In some cases, it will be necessary to go to a level below that, but in most cases we think the operating segment will be where this goodwill resides.

There is an initial requirement to measure the fair value of that, what we call reporting unit, at the time that an acquisition is made. That serves as benchmark for subsequent measurements. And the methodology that is used in that initial fair value needs to be documented and retained by the company.

Subsequently, each year, at least each year, and in the case where there are other indicators of, let's say, adverse events, to summarize, the tests may need to be performed more often than once a year. But each year the fair value of that reporting unit and every reporting units that contains goodwill needs to be determined and evaluated against the fair value of the individual underlying assets, excluding the goodwill. To the extent that the fair value of the reporting unit is less than the fair value of the underlying assets and liabilities, excluding goodwill, goodwill is impaired and must be written down.

So it does require fair value determinations, which can be subjective. And yet, there is a very sufficient methodology in the marketplace today to determine fair value.

We went through an extensive due process in testing this methodology. Mr. Rogstad has said in his statement, he participated in a presentation to us on similar methodology, one we developed from that presentation and others. We have discussed this with many business corporations and entities in the process of reaching our final conclusions. And we believe we have an operational test for goodwill impairment.

Can it be gamed? Well, that depends in part on the diligence and dedication of companies themselves and their auditors.

We have many estimates that we use in accounting. Almost everything in accounting is estimate.

Mr. TOWNS. I was doing fine up to that point.

Mr. JENKINS. So there is judgment involved in almost everything, maybe even cash today is an estimate. I do not know. But certainly everything else is the value of your inventory. We have had a requirement in accounting for many, many years that you can never carry an asset at more than what it is worth. And while we do not adjust to that worth if it is up, we have always had what we called impairment tests for inventory. We have loss reserves for receivables. We have impairment tests for buildings and equipment. And this is a similar approach but actually a more rigorous and well-documented approach than we, perhaps, have in other areas.

Mr. TOWNS. Is there anything Congress can do other than pray?

Mr. JENKINS. Well, prayer is always in order, I believe. But in addition, I think you can urge your constituents, as we will urge ours, and basically our constituencies are the same, I believe, to apply this standard in good faith, in an objective way and with rigor.

Mr. TOWNS. Thank you very much.

Mr. Rogstad, let me ask you, it appears to be your testimony that FASB should not act until the industry has achieved consensus on an issue. Isn't this a recipe for gridlock?

If Congress waited for the industry's consensus on issues like energy, health, telecommunications, we would never legislate a thing around here. We would just be sitting here, twiddling our thumbs.

Isn't it more reasonable to ask FASB to exercise leadership on accounting standards, while meeting with and listening to its constituent groups and making the necessary revisions? Otherwise, you will probably never achieve timely improvements to accounting standards.

Mr. ROGSTAD. Congressman Towns, I think it is the level of consensus that I am referring to here. Obviously, these are areas of incredible complexity. The notion that all users are going to ever agree on all aspects of this is not what I am talking about here. And there is a degree of healthy regulatory tension, part of which is always divides different views on some of these subjects.

I do believe, however, and what I was trying to say in my prepared statement was, that we did reach a point in this process that FASB appeared to be heading in a direction that, as I noted, a reading of the record, as it is stated in public there at that point in time, was very difficult to say, "How did you arrive at a central tendency, never mind a very detailed consensus, a just mainstream central tendency of where this project was going?" based on all the intervener statements that had been made at that point in time.

I think how FASB got to the point that they were stating at that juncture was not transparent. It is the consideration process, to pick up on Mr. Jenkins' word, that I did not think was transparent at that point, that caused everybody to reload and take another look at this.

You do have to gradually converge toward a central tendency here, which is what I mean by consensus. And I think FASB, in the second half of this project, did that in a very, very notable way.

But in the middle, to repeat, I thought there was not, on the basis of major statements by whole classes of interveners across accounting firms, across policy officials, across businesses, across financial institutions, there was just disparity all over the place, and very difficult to see that central tendency. And I think you have to start there and move a process forward based on that level of consensus. And I think that it is a level of detail, sir, I think.

Mr. TOWNS. Mr. Chairman, I know my time has expired, but could I just have a minute to ask Mr. Jenkins to respond to Mr. Rogstad's claim that FASB's process is broken and needs to be repaired?

Mr. JENKINS. I would be very happy, and I appreciate the opportunity to do that.

I particularly object to Mr. Rogstad's claim that we were intransigent at any point in this project. That simply, in my judgment, is not the case.

There is no group that we met with more often or listened to more careful than the American Business Conference. I cannot right now tell you how many times during the course of this project that I met with Mr. Rogstad and with his associates, with his

members. They came to the FASB on more than one occasion and we listened carefully to them.

The routine of our process, that Mr. Rogstad suggests we need to improve, contemplates change during the course of a project. That is why we issue documents for exposure and comment, so that we can hear and make changes accordingly. You cannot find a final standard at the FASB that is exactly the same, usually in some fairly significant way, from the exposure draft or drafts.

We do make changes. That is evidence of the involvement and the process of working together with all of our constituencies. If we knew enough before we issued a document for exposure and comment to be 100 percent confident that we had the right answer, we would not bother with the exposure draft, not would we bother with public hearings and the extensive process, nor would we bother with educational measures. This is part of our normal process, and we do listen and learn.

And on the basic issue of eliminating pooling of interest accounting, the basic issue, we did receive strong support from our constituencies at the exposure draft period of time. The issue then turned to focus on this goodwill issue, which we resolved as a result of continuing our full, open due process. Thank you.

Mr. TOWNS. Mr. Chairman, allow me to request that the material be part of the record, submitted and become a part of the record. Mr. Jenkins indicated, in fact, that he had all this information, material for the record, because of the fact there were several meetings, several discussions, and we would like to have this be part of the record.

Mr. STEARNS. Mr. Jenkins, do you understand he is asking that the references that you have alluded to, he would like to make that part of the record, if that is possible?

Mr. JENKINS. With respect to the meetings with the American Business Conference?

Mr. TOWNS. Yes, that is correct.

Mr. JENKINS. We would be glad to provide that information to you, yes.

Mr. STEARNS. Okay.

The gentleman's time has expired.

The gentleman from Illinois?

Mr. SHIMKUS. Thank you, Mr. Chairman. I am just going to start and then I will go into my questions.

Mr. Rogstad, in your testimony you say, "Did the FASB process, as used in the business combinations project, produce a good result?" And you say, the answer, yes. And then you also go on to say, "It could be more improved." Much like what we do here in Washington; it gets pretty messy in how we eventually move something, but the ultimately objective is whether you get a product that works. And I would suggest that, even though this process got to a slow start, it was fairly satisfactorily concluded by most of the major parties.

And I do have a question about the role of, actually a caution of the role of how much you would encourage elected officials to be actively intervening in rulemaking. You might get what you wish, which is an active role by public policymakers that spin on the whim of, sometimes on public perception, where your profession is

a, what we are talking about is numbers and decimal points and stuff that do not have to carry the whim of public emotion at the time. There is a fine line, and I would just be cautious.

Let me go to the international arena. Part of this subcommittee also has a trade jurisdiction. And, Mr. Leisenring and Mr. Jenkins, first of all, is the EU attempting at all to have some interplay in the financial accounting systems of the EU members, and how does that reflect on what we are doing here?

I am very cautious and skeptical of EU and how, because of its merging, has created additional barriers to trade for us, along with our allies in the EU. How does this play out in the financial accounting market?

Mr. LEISENRING. The EU has historically had a significant involvement in financial reporting, within the countries within Europe. They have had a series of directives and they are much more law-driven toward their financial reporting than we have been in the United States.

The EU, however, has seemed to embrace fairly enthusiastically the notion of international accounting standards. They have proposed legislation that has not passed as yet, but proposed and is highly anticipated that it will, that would require all European companies that are what we would call public companies, the same as SEC registrants, across Europe to comply with the international accounting standards by the year 2005. That would seem to drop the barriers and the differences across Europe and be a rather fundamental breakthrough.

That is the good news side of it. There is at least a cautionary side, and your skepticism, Congressman, I personally find well taken. They have done that and made that endorsement, but done it also by forming a committee that is going to look at the product of the board that I serve on, International Accounting Standards Board, to access the suitability of those standards.

If, as they describe it, that committee's work is to provide insight and input of the deliberative process, participate in the due process, as we have been talking about on the other project, I think it would be very constructive. If it is intended to do something other than that, it raises the warning flags that you are worried about.

I think we do not know how they will behave in that regard. They are certainly going to get a significant amount of pressure from the IASB, the FASB, the Accounting Standards Board in Great Britain, the Canadians, the Australians, the Germans, all of them are not or share the same concerns.

So, I do not think within the private sector that there is an enthusiasm for this group, but it is a reality that we are going to deal with, and hope that they are constructive part of the process.

Mr. SHIMKUS. Mr. Jenkins, do you want to respond?

Mr. JENKINS. I would share Mr. Leisenring's comments there. The thing I would add is that the deadline that they have proposed to impose of 2005 in my judgment is premature, particularly since it would require the adoption of international accounting standards by companies within the European community, even those companies that currently report under U.S. generally accepted accounting standards.

Many of them do that as an efficient way of accessing our capital market. They would then be required to revert to international standards, and presumably reconcile the U.S. standards, a costly exercise, and one that probably does not provide full U.S. transparency.

Beyond that, while I think the structure is in place and the process is there to develop strong, high-quality standards going forward, my judgment, the totality of the existing international standards are not the sufficient quality to be used in U.S. reporting or as a substitute for U.S. financial statements. And therefore I would be reluctant to endorse a process that would require the use of IS at this point in time.

In order to adopt the standards by 2005, companies, in effect, have to begin doing this in 2003 just to get the 3 years of required information recorded. We are not going to have very many new international standards of high quality by 2003, just 2 years from now.

Mr. LEISENRING. If I may, Congressman, I just agree with Mr. Jenkins comment. So that you do not believe there is any disagreement, I agree about his comment about the totality of international standards, at the present time not suitable.

Mr. SHIMKUS. And I would just finish by saying, you know, I am concerned that there is a higher, there may be a higher cost of capital through the differing standards, and if ours are more stringent, and that is the unlevel playing field that is hard to figure out when we are talking about crunching of numbers and evaluating portfolios versus actual trade.

With that, Mr. Chairman, I yield back my time.

Mr. STEARNS. I thank the gentleman.

The gentlelady from California?

Ms. ESHOO. Thank you, Mr. Chairman.

I have several questions, and I also have some amendments up at the Rules Committee, so I am sure you want this to move quickly and I will move through the questions, and if you can keep them as brief as possible, but obviously with some answers.

I am curious about the IASB and how there will be a harmonization with what we have.

And I think that some of the questions that members have asked were directed in this area. Will they have the same open and transparent procedures as FASB in setting their agenda and formulating their rules and will they have the same due process requirements?

Mr. LEISENRING. The short answer to that is yes.

Ms. ESHOO. Is yes.

Mr. LEISENRING. An identical, as I said no, but public meetings, required exposure periods, public hearings, the same activity level, conducted perhaps differently because the international circumstance make it difficult, for example, with the Japanese and the Chinese and the Australians to simultaneously participate in the hearings, so.

Ms. ESHOO. Will the rule issued by one body be superseded by another?

Mr. LEISENRING. Let's keep it in the United States. The FASB absolutely has the authority to issue standards through the SEC

and the ICPA in the United States. The goal is to make the differences between those standards become so trivial that it is not consequential. But there is no authority for the IASB to issue something that overrules the FASB or vice versa, because the FASB has its own jurisdiction and the IASB has none other than to the extent people in other countries are allowed to use non-domestic standards for cross-border financing.

Ms. ESHOO. So the restructuring of the IASB is being done for what reasons? I mean, it is probably obvious, but I mean, if they cannot supersede, it is meant to harmonize, how is that different from how it is operated?

Mr. LEISENRING. Well, I think Mr. Jenkins can comment on this from their exclusive perspective. I think, as long as you accept that the objectives of the FASB is a comparable information or a decision useful to investors, that they can discriminate between investment and alternatives because of the quality of the information they have, it does not seem like borders ought to change that in a world where capital flows are so easily done across continents, much less across borders. There is no real jurisdiction or authority to accomplish that, if it is not done by a private sector organization, like the IASC.

You could argue that the FASB which, I think is widely regarded by everyone in the world, as setting the highest level of accounting standards, should have done the accounting standards the world was willing to adopt. I can assure you, Congresswoman, that is not the case. They are not ready to just say, "The American way is the way we want to do it."

Now they may end up with a very similar answer, but they seem to want to have their own participation in that process. So I think we all made a conscious decisions that if you agree on the objectives of getting a single set of high-quality standards, the alternative organization in partnership with the FASB and other standard setters is a more efficient way to get there, than to try and, for example, reorganize the FASB and make it look a little more international.

Ms. ESHOO. I especially thank you for your answer. I especially appreciate the "Restructuring In Brief." I mean, it is here at the podium and as others were asking questions, I went over it.

Just a couple of curiosity questions about it. On the first page, it talks about the supervision, the restructuring, the blue ribbon nominating committee, and it is blue ribbon, because it is chaired by the former chairman of the SEC, Arthur Levitt.

How is the board funded? It says fund-raising here. And so, does each company contribute? Where does the money come from?

Mr. LEISENRING. It would be nice if it would. But no, the funding actually of the IASB is very similar now, is very similar under the restructuring as the FASB's. There is a significant amount of private contribution.

Ms. ESHOO. From whom, though? I mean, just give us an idea of who.

Mr. LEISENRING. Each of the five largest accounting firms promised a significant amount of money over 5 years. A great many major corporations around the world have similarly done the same thing, financial institutions.

Ms. ESHOO. I am not saying it to aggravate you. Just a curiosity question.

Mr. LEISENRING. No, no. Financial institutions. I actually have never seen the donor list. I know of some that have said to me, "We have contributed so much," and they are names that you would know in the United States and they are the same people that contribute to the FASB.

Ms. ESHOO. In the same memo there is some mention about the need to provide competitive salaries to attract high-caliber candidates for board positions and that the proposed salaries will generally match the level of members of FASB in the United States. What is that level?

Mr. JENKINS. The current level for an FASB board member is \$420,000 annually.

Ms. ESHOO. And is that considered a full-time position?

Mr. JENKINS. Yes. Yes. The FASB, in order to have——

Ms. ESHOO. I think there would be a lot of members here interested in serving on the board, Mr. Jenkins.

Mr. JENKINS. Well, it should not be a surprise.

I will tell you that members do not join the FASB for the money. But in order to be independent and objective in our decisionmaking——

Ms. ESHOO. Nor do we want to be or serve as Members of Congress for the money either.

Mr. JENKINS. Exactly.

We need to be independent, and, therefore, we are full-time. The ISB is structured, in a nutshell, if you want a short answer, the new FASB structure is virtually identical to the FASB structure. It is designed to give independence, private sector approach, and to significantly improve on the old structure which was not independent and objective. The members were part-time. If you wanted to be an FASB member, you had to pay to be an ISB member, if you had to pay, or your organization had to pay; that is hardly a way to get objective decisionmaking accomplished. Their due process was lacking, and therefore their standards did not have the credibility that hopefully ours do.

The restructuring, which took a long time, was designed to accomplish that, and I think it has, and that is why I have great hopes for it.

Ms. ESHOO. Well, I once again appreciate, not only the opportunity that the hearing represents to hear you and to ask questions, but I also recognize that there are tensions of values between the FASB and the Congress. I view them as being healthy. They are not going to go away. We as human beings in our interactions with one another are not always going to see eye to eye. But wherever there are either standards and/or representation relative to our national economy and our international economy, we are going to be working together.

So I look forward to that future and I thank the chairman for having this general oversight hearing.

Mr. STEARNS. I thank the gentlelady.

The gentleman from Chicago, Mr. Rush?

Mr. RUSH. Thank you, Mr. Chairman.

Mr. Chairman and witnesses, I want to begin by apologizing. I know I missed some of the testimony; I was at a number of conflicting appointments this morning, meetings this morning. And so some of these questions might have been asked and answered already, but please indulge me, if you will.

Mr. Rogstad, in your testimony, you mentioned the importance of FASB performance consensus building across user groups in determining new accounting principles. You also note the ever-increasing number of households that own stocks. What would FASB do to make sure that this large contingent of household investors, that they be included in your consensus-building process?

Mr. ROGSTAD. I think, Congressman, that those groups are increasingly represented by an organization that represent classes of investors, shareholders, securities industry in general, and I think that there is, and there was in this process, ample testimony and submissions for the record and for FASB's consideration that incorporated the views and growing importance of the views of this rapidly growing component of the population that has great interest in the financial markets.

Mr. RUSH. What would be the profile of the input from consumers? Would that profile be more organized, in terms of consumer interest groups, or would that profile be more individuals that appear before you?

Mr. ROGSTAD. I would probably let Chairman Jenkins answer that better than I could.

Mr. JENKINS. I would say that we do have contact with and receive inputs and carry on due process with consumer groups and, therefore, with consumers. Some place in the thick stack of materials that we provided you for this meeting are excerpts from comment letters that we received on our process on business combinations and other evidence that, I think, that our process is exhausted and is working. And these letters were received during the first exposure draft in our process.

But, for example, we heard from the Consumer Federation of America, that represents 260 consumer groups, and they wrote in support of FASB's decisions to eliminate pooling of interest accounting.

Nel Minow, who is from Chicago, Congressman Rush, and who you know and I know, as well, since I come from Chicago as well, editor of the Corporate Library and a consumer advocate has long weighed in on financial reporting issues and in support of transparency of information and so on.

We have Sarah Teslik, who represents perhaps more institutional investors, but does so from the focus of investors in mutual funds, in 401(k) plans, in pension plans, where a vast majority of this 50 percent of equity ownership by individuals resides. They do not probably own those shares directly, but they do through one of these other vehicles. So Sarah Teslik, from the Council of Institutional Investors, another group that we have interchange and due process with and, again, supported our work on business combinations. Those would just be some examples.

Mr. RUSH. Well, as have been indicated by you and by others, Mr. Jenkins, we know that more and more Americans are depending on stocks for their retirements, particularly, and also long-term

investments. I guess, as a segue into your comments, do you think that the information that these investors are getting is, are they more accessible now? Is the information more easily understood now? Are you getting that kind of feedback from your comments and your interaction with these consumers, these investors?

Mr. JENKINS. I think, in total, when you look at not only financial reporting, but you look at other forms of communication and information, would be web sites that companies have today where they are reporting a significant amount of information, the study that I referred to that we did and reported on, I am not sure whether you were here when I commented on it earlier, the study that we did earlier this year about the voluntary disclosures of information encompass all kinds of public disclosures, not just financial reports, but it focused on web sites, it focused on access that investors have to corporate meetings with analysts that are now open to telephone discussions so an investor can call up and listen to these meetings. There is a great deal going on and much more information.

The issues is whether that information is presented in the proper context that it can be understood. And that is why I called for a presentation of this information in conjunction with the reporting of GAAP financial information so that investors can see the difference between the two and hopefully reconcile and, therefore, understand these kinds of performance metrics and other things that are being reported.

Mr. STEARNS. Thank the gentleman.

We are going to go another round, Mr. Rush, if you want to stay and if Mr. Towns comes back.

I want to direct my questions to Mr. Leisenring, dealing with two issues: business combination and stock options accounting. Now when I talked to Mr. Jenkins about what he was talking about with pooling, did you have that problem? Do corporations in Europe have that problem that you need to issue the same type of regulation, the 141 and 142 standards?

Mr. LEISENRING. Well, it is not, of course, just Europe. If you were talking about Australia and New Zealand, they never allow pooling.

Mr. STEARNS. They never allow pooling. Okay. Did they allow it in Europe?

Mr. LEISENRING. At the present time it depends on which country in Europe you are talking about because it is very varied. So I think it is easier to focus on the international standards versus the FASB.

And the international standard has been viewed as being far more restrictive on the ability to employ what they called uniting of interests, but it meant the same thing.

Mr. STEARNS. Which is pooling.

Mr. LEISENRING. I am not sure that that is an accurate reading of what necessarily happened in practice everywhere.

Mr. STEARNS. But it is not prevalent in the international.

Mr. LEISENRING. It is less prevalent than it was in the United States, I believe. That does not change the conceptual basis for having what is clearly anomalous accounting, as Mr. Jenkins has

described. And there are some high-profile combinations that have the——

Mr. STEARNS. So you can still do it in the international scene.

Mr. LEISENRING. The international——

Mr. STEARNS. Even though Mr. Jenkins has issued these, promulgated these new standards, it does not apply to Europe, obviously, or apply to the international scene. So some corporations can still do pooling?

Mr. LEISENRING. Absolutely.

Mr. STEARNS. Okay. Now, do they also do the pro forma type of presentation prior to their audited GAAP?

Mr. LEISENRING. There is not the same amount of disclosure of information that you would consider to be other than the GAAP-reported information in other parts of the world. But it is increasing. There is more of it, by the same types of companies and probably for the same reasons.

But one of the things that is not as focused internationally is quarterly financial reporting; in fact, that is the exception not the rule. So that they do not have as much periodic reporting, which seems to drive much of this and the short-term fixation on stock pricing in the United States. So it has not been as widespread, but it is not. We cannot say that it does not happen, because it does in certain countries.

To the point of pooling, yes, they can still do pooling and will be able to for some period of time. But the IASB's agenda includes a project intended to look at exactly the same questions that FASB has. And I believe there will be no sympathy for maintaining a pooling of interest notion.

Mr. STEARNS. So you expect to issue standards in your organization much like FASB does?

Mr. LEISENRING. It would be——

Mr. STEARNS. Ninety percent sure.

Mr. LEISENRING. [continuing] inappropriate for me to speculate on a group I have never watched yet actually come down and promulgate a standard how they will come out. But I believe from the discussions that we have had at the board meeting last week, there is only a couple of jurisdictions with sympathy for retaining pooling of interest.

Mr. STEARNS. These are the board members that make \$600,000 instead of \$400,000.

Mr. LEISENRING. Yes. It is the strength of the dollar, has given me a 4.62 percent pay cut already this year, according to the paper this morning, because I am paid in pounds.

Mr. STEARNS. Oh, I see. Okay.

Do you agree with Mr. Rogstad when he said that there should be some standards put on these pro forma?

Mr. LEISENRING. There is not any doubt in my mind that the information is potentially misleading.

Mr. STEARNS. Just yes or no.

Mr. LEISENRING. Whether or not a private standard-setting organization can do that or not, I think I would have to defer to some lawyers. I am not sure of our ability to have jurisdiction over press releases.

Mr. STEARNS. No, no, no, the question is, as a member of the board, do you think, like Mr. Rogstad said, that there should be some standards for the pro forma; just yes or no?

Mr. LEISENRING. Highly desirable, yes.

Mr. STEARNS. Okay. Let me just quickly, in the time I have left, talk about stock options, how they get dealt with in terms of showing up on the books on the international scene, and then we will talk to Mr. Jenkins.

I am an employee of a large corporation and I have stock. Let's say I had a stock valued at \$10,000 and then I sell it 2 years later for \$50,000, so a \$40,000 profit as an employee. Where is the controversy in here? And is there anything you are doing to solve the problem?

Mr. LEISENRING. I do not think the controversy is with the stock you own or its changes in price. The controversy historically in the United States, and I predict will be internationally, is over accounting for the granting of an option.

Mr. STEARNS. Okay.

Mr. LEISENRING. And to acquire the stock at some perhaps set price or some variable price.

The international standards are nonexistent.

Mr. STEARNS. Okay. So I have an option to buy \$10,000 worth of stock, 10,000 shares at \$1, and the stock is now at \$5. It is not even shown on the books or anything?

Mr. LEISENRING. There are no international standards with respect to stock options.

Mr. STEARNS. Okay.

Mr. LEISENRING. Now there are jurisdictions that do, in fact, account for stock options. I am not quite sure why, I guess it is cultural. The Germans have issued an exposure draft just 2 weeks ago that would require grant a fair value for all stock options; a proposal very similar to the one the FASB suggested several years ago. The International Accounting Standards Board has voted to put share-based compensation on its agenda. It is a widespread concern, particularly in Europe.

Mr. STEARNS. What is the concern?

Mr. LEISENRING. The concern is that there are absolutely no standards for accounting, and the standards in the United States, even the standards in the United States prior to the FASB's recent project, are nonexistent internationally.

Mr. STEARNS. So what does it mean as an investor and I look at the P&L statement in a European company? Is there some case that by not having it in there it would help the P&L statement look better?

Mr. LEISENRING. Let's back up.

Mr. STEARNS. I mean, I just do not have the accounting experience to know.

Mr. LEISENRING. There are three possibilities. One that we know for sure, in the international community where you will not have the body of information that you have in the United States because of the issuance of statement 123. While it did not require recognition of stock option expense, the disclosure would provide a user a way of compensating, excuse the pun, for not having compensation expense in the income statement.

However, internationally you could have two other possibilities. In the United States we have always expensed, or have for 30 years, certain types of stock options. That is not true internationally.

Mr. STEARNS. Just never shows on the books, the expense forms.

Mr. LEISENRING. Not internationally. Those options are relatively rare on the grand scheme of things compared to the type of options that also do not show on the books anywhere in the United States.

So you can have a situation exactly comparable to the United States in terms of measurement, if you had a certain type of option you would have a more lenient treatment, no compensation internationally, where you would have compensation in the United States, but in all circumstances internationally you would not have the body of information about the options granted that exist in the United States.

One of the reasons for the project internationally is that however it comes out, it has not even caught up to where the United States is. And as you probably know, I do not personally believe that the United States accounting is particularly exemplary.

Mr. STEARNS. Okay.

Mr. Jenkins, anything you want to add to that, and then I will close?

Mr. JENKINS. I basically agree with Mr. Leisenring in his explanation of the status. In most countries, and certainly in the international standards, because there is no accounting, even stock schemes that result in the payment of cash instead of stock, at the end of the day, still do not get counted for as expense.

They would under our existing standards. And there are many other cases where we would have some compensation but you would not otherwise. Our disclosures are now providing much better information to investors on stock compensation than they did.

I am pleased that the IASB intends to take up a project in this area, in the hopes that they will be able to come closer to where we are today.

Mr. STEARNS. Thank you. My time has expired.

The ranking member, Mr. Towns?

Mr. TOWNS. Mr. Chairman, I will only ask unanimous consent to put Mr. Dingell's statement in the record. I am asking for him to be able to add a statement for the record.

Mr. STEARNS. With unanimous consent, so ordered.

Mr. TOWNS. The ranking committee is tied up this morning continuing negotiation with the patients' bill of rights legislation in the Rules Committee hearing, and the pending energy legislation and, therefore is unable to attend today's hearing.

He has, however, has asked you to note for the record the strong support for FASB and its work and the work of this subcommittee and request the ability to submit a statement for the record on this extremely important issue.

Mr. STEARNS. By unanimous consent, so ordered.

Mr. Rush, do you have any additional questions?

Mr. RUSH. Mr. Chairman, I just have one or two additional questions here.

Mr. Jenkins, an impairment test, I am not sure if you addressed that, for intangible assets. And I guess the general consensus is that all tangible assets may not be depreciated.

Mr. JENKINS. Certain intangibles and goodwill need not be depreciated.

Mr. RUSH. Okay. Now, we are in the midst of a slowing economy now. Can you tell me what the varying effect on an impairment principle, based on the fact that this economy is slowing down?

Mr. JENKINS. It is possible because there would be, yes. The impairment test is based on the determined fair value of the particular intangible or goodwill intangible, and at the end of the day fair value basically is the discounted value of future cash-flows.

To the extent that the economy is turning down, and that that is predicted to last for an extensive period of time, then the future cash-flows might be less, and, therefore, that would lead to a lower fair value. Now, that alone would not be a write-down, but if that fair value was less than what you had the intangible on the books for, it would lead to a partial write-down of that intangible.

On the other hand, if you believe that the slow-down is not going to be long-lasting and it is a dip then and you can support that based on your understanding of the marketplace, then the current dip might not have an adverse effect on the impairment test.

Mr. RUSH. Just a final question, Mr. Chairman.

What is the level of public input for the IASB? Is there a comparable level as it relates to FASB?

Mr. LEISENRING. Congressman Rush, that is difficult to answer because the IASB as such has only been in existence since April 1 and has issued no exposure drafts or anything. So in terms of the way it is structured now, I would anticipate the answer to your question, yes, it will be very comparable.

Historically, the predecessor organization had an open due process. They had open meetings. They had exposure drafts. The level of public involvement considering worldwide was not high. It was concentrated in certain jurisdictions, and particularly was not high from the United States.

It is increasingly more from the United States. And because of the legislation that we talked about earlier in your absence, by the European Commission requiring European companies to use those standards by 2005 that comes about, I suspect, there will be a lot more involvement from Europe.

So I think it will end up to very similar. I would be disappointed if it was not, and I anticipate that it will be.

Mr. JENKINS. It is designed to be the same. It is up to the constituents as to whether they choose to take advantage of the process.

Mr. RUSH. Okay. Thank you so much.

I yield back, Mr. Chairman.

Mr. STEARNS. I thank the gentleman.

Our hearing is completed.

Mr. Rogstad, yes, sir?

Mr. ROGSTAD. My Chairman, might I ask permission to introduce into the record a memorandum that we wrote in July of last year, which spelled out the issues that underscored, at that time, our

concerns with the process? I realize this was a charged conversation.

Mr. STEARNS. No, I welcome that.

Mr. ROGSTAD. We just laid that all out.

Mr. STEARNS. No. You mentioned that earlier about this process. And so, we would appreciate that.

Mr. ROGSTAD. I would like to add as part of the record. Because I think it did document a concern at that point in time, which all of our motivation is to make sure we never get back to again. So I would like to have that.

Mr. STEARNS. By unanimous consent, so ordered.

When was the memo dated?

Mr. ROGSTAD. I believe, July 20, 2000.

Mr. STEARNS. Okay.

Mr. JENKINS. And, Mr. Chairman, we responded to that memo, and I would appreciate the opportunity to put that into the record.

Mr. STEARNS. By unanimous consent, so ordered. We will have the whole record in its entirety.

Let me conclude by saying, I appreciate the three of you coming here voluntarily to help out. We have had, I think, a pretty good debate upon some of the recent actions that your organizations have been involved with. I think it goes to the point that with a global economy on the horizon or presently that we are in, updating standards to reflect the realities of what exists is very important. And you folks are on the cutting edge and we need your help here. And, I think, for the members, including myself, it has been very edifying. So thank you very much.

The committee is adjourned.

[Whereupon, at 11:58 a.m., the subcommittee was adjourned.]